# TRANSCRIPT OF RECORD.

## SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1914 1915

No. 393

TYEE REALTY COMPANY, PLAINTIFF IN ERROR,

*vs.*

CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE.

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK.

FILED MARCH 12, 1915.

(24,612)

# (24,612)

# SUPREME COURT OF THE UNITED STATES.

**OCTOBER TERM, 1914.**

# No. 868.

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TYEE REALTY COMPANY, PLAINTIFF IN ERROR,

*vs.*

CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE.

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IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK.

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., MARCH 23, 1915.

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B. T.

UNITED STATES OF AMERICA, *ss*:

The President of the United States of America to the Judges of the District Court of the United States for the Southern District of New York, Greeting:

Because in the records and proceedings and also in the rendition of the judgment of a plea which is in the said District Court before you between Tyee Realty Company, plaintiff, and Charles W. Anderson, defendant, a manifest error has happened to the great damage of the said Tyee Realty Company as by its complaint appears. We being willing that the error, if any has been, should be duly corrected and full and speedy justice done to the parties aforesaid in this behalf, do command you if judgment be therein given that under your seal distinctly and openly you send the record and proceedings aforesaid, with all things concerning the same, to the Supreme Court of the United States together with this writ so that you may have the same at the City of Washington on the 23rd day of March 1915 in the said Supreme Court to be then and there held that the record and proceedings aforesaid being inspected the said Supreme Court may cause further to be done to correct that error what of right and according to the laws and customs of the United States should be done.

Witness the Honorable Edward D. White, Chief Justice of the United States, the 24th day of February, in the year of our Lord One thousand nine hundred and fifteen and of the independence of the United States of America the one hundred thirty-ninth.

ALEX. GILCHRIST, JR.,
*Clerk of the District Court of the United States*
*for the Southern District of New York.*

Allowed by
J. M. MAYER,
*District Judge.*

2 UNITED STATES OF AMERICA,
*Southern District of New York, ss:*

I, Alexander Gilchrist, Jr., Clerk of the District Court of the United States of America, for the Southern District of New York, in the Second Circuit, by virtue of the foregoing Writ of Error, and in obedience thereto, do hereby certify, that the following pages numbered from four to 29 inclusive, contain a true and complete transcript of the record and proceedings had in said Court in the cause of Tyee Realty Company, Plaintiff in Error, against Charles W. Anderson, Defendant in Error, as the same remain of record and on file in said office.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District

of New York, in the Second Circuit, this 11th day of March, in the year of our Lord one thousand nine hundred and fifteen, and of the Independence of the United States the one hundred and thirty-ninth.

[Seal District Court of the United States, Southern District of N. Y.]

ALEX. GILCHRIST, JR., *Clerk.*

3 [Endorsed:] L13—194. Dist. Court of the U. S., Southern Dist. of N. Y. Tyee Realty Company, Plaintiff, against Charles W. Anderson, Defendant. Original. Writ of Error. Davies, Auerbach & Cornell, Attorneys for Plaintiff, Mutual Life Building, 34 Nassau Street, New York City. U. S. District Court, S. D. of N. Y. Filed Feb. 24, 1915. 1.10. K.

4 United States District Court for the Southern District of New York.

TYEE REALTY COMPANY
against
CHARLES W. ANDERSON.

To the above-named Defendant:

You are hereby summoned to answer the complaint in this action, and to serve a copy of your answer on the plaintiff's attorney within twenty days after the service of this summons, exclusive of the day of service; and in case of your failure to appear, or answer, judgment will be taken against you by default for the relief demanded in the complaint.

Witness, the Hon. Charles M. Hough, Judge of the District Court of the United States for the Southern District of New York, at the City of New York, this 10th day of November in the year one thousand nine hundred and fourteen.

ALEX. GILCHRIST, JR., *Clerk.*
DAVIES, AUERBACH & CORNELL,
*Plaintiff's Attorneys.*

Office and Post Office Address, 34 Nassau St., Borough of Manhattan, New York City.

5 Office Copy.

United States District Court, Southern District of New York.

TYEE REALTY COMPANY, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

*Affidavit of Service of Summons and Complaint.*

STATE AND COUNTY OF NEW YORK, *ss:*

Jesse C. Millard, being duly sworn, says, that he is over twenty-one years of age, And that on the 14th day of November, 1914, at

the United States Customs House, Borough of Manhattan, City, County & State of New York he served the summons and complaint in this section, hereto annexed, upon Charles W. Anderson defendant in this action, by delivering a true copy of said summons and complaint to such defendant personally, and leaving the same with him. He further says, that he knew the person served as aforesaid to be the person mentioned and described in the said summons as the defendant in this action.

JESSE C. MILLARD.

*New York County Register's No.* 6003. *Commission Expires March* 30, 1916.

Sworn to before me, this 16th day of November 1914.

[Seal Frank C. Titus, Notary Public, New York County.]

FRANK C. TITUS,
*Notary Public, New York County, No.* 3846.

6 In the District Court of the United States for the Southern District of New York.

TYEE REALTY COMPANY, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

*Complaint.*

The plaintiff Tyee Realty Company, by Davies, Auerbach & Cornell, its attorneys, complaining of the defendant, respectfully shows:

First. The Plaintiff is a corporation duly organized and existing under and pursuant to the laws of the State of New York, having its principal place of business at No. 19 Cedar Street, in the Borough of Manhattan, City of New York, in the Southern District of New York, and in the Second Collection District of said State.

Second. The defendant is the Collector of Internal Revenue for the Second Collection District of the State of New York.

Tird. The business for which the plaintiff was organized and the only business which the plaintiff has ever conducted is the holding for investment of real property in the State of New York. The plaintiff was incorporated on the 10th day of April, 1906, under the Business Corporations Law of the State of New York, with an authorized capital stock of $10,000, all of which has been fully paid and duly issued. It purchased certain real property in the City of New York, subject to an indebtedness secured by mortgage.

7 amounting to $150,000, which was increased in 1908 to $200,000 and in 1911 to $275,000. On the 7th day of October, 1913, $5,000 of this indebtedness was paid off, leaving the total indebtedness of the plaintiff outstanding on December 31, 1913, $270,000.

The capitalization of the plaintiff mainly by means of mortgage indebtedness was in accordance with the public policy of the State of New York, as expressed in its Tax Laws, which laws are so framed as to encourage in the case of realty corporations the capitalization of the enterprise by a large amount of mortgage bonds and a relatively small capital stock. The tax upon mortgage indebtedness is permitted to be paid and in the case of your petitioner has been wholly paid, once for all by means of a recording tax, at the rate of one-half of one per centum of the principal of the mortgage debt, in consideration of which the said debt and the bonds or other instruments representing the same are exempt from taxation so long as the mortgage or any extension thereof continues in force. The annual taxation upon this form of capitalization, therefore, may be taken to be equal to the legal interest upon the amount paid as a recording tax, or three-tenths of a mill upon each dollar of the principal debt. The annual tax upon capital stock required to be paid to the State Comptroller is three-quarters of a mill upon each dollar of the capital stock.

The laws of New York are also so framed as to encourage in the formation of corporations such as the plaintiff a small nom-
8 inal capital stock as compared with the actual value of the property used by the corporation, because the organization tax is proportioned to the par value of the capital stock and not to its actual value. Furthermore, the laws of New York in respect to the general property tax, which in the case of corporations is called a tax on capital stock and surplus, are so framed as to encourage and favor the method of capitalization adopted by the plaintiff, in that by such laws the plaintiff is authorized to deduct from the aggregate value of its property not only the assessed valuation of its real estate, but also the outstanding indebtedness secured by mortgage upon its real estate.

The above mentioned provisions of the laws of New York form part of a system of taxation deliberately adopted as the result of many years of experimentation and discussion, whereby direct taxes for State purposes have been practically eliminated and the jealousies, controversies and recriminations which formerly existed between different sections of the State, on account of alleged inequalities in respect to direct taxation, have been eliminated. In addition, by the system of taxation above referred to, the formation under the laws of New York of corporations designed to do business in that State, as distinguished from the organization of such corporations under the laws of other States, has been promoted, the issuance by real estate corporations of large volumes of stock for speculative purposes has been discouraged and the interests of the people of the State of New York in respect to matters wholly within the jurisdiction and control of their State government have been safe-
9 guarded in many other ways according to the best judgment of those who have from time to time been charged with the duty of determining the legislative policy of the State.

Fourth. On or about the 21st day of May, 1914, under the alleged authority of Section 38 of the Act of Congress approved August 5,

1909, entitled "An Act to provide Revenue, Equalize Duties, Encourage the Industries of the United States and for other Purposes" and of Section 2 of the Act of Congress approved October 3, 1913, entitled "An Act to Reduce Tariff Duties and to Provide Revenue for the Government and for Other Purposes", there was assessed upon the plaintiff by the Commissioner of Internal Revenue a tax of Seventy and 64/100 Dollars ($70.64), and thereafter notice of such assessment was duly given to the petitioner and a demand made upon the petitioner by the defendant for the payment of said tax on or before the 30th day of June, 1914, at the United States Customs House Building in the City of New York, in order to avoid penalty and interest. On or about the 15th day of July, 1914, a further notice and demand for payment of said tax was served upon the plaintiff by the defendant accompanied by a threat to distrain the property of the plaintiff if said tax was not paid within ten days. Thereafter and on or about the 21st day of July, 1914, the plaintiff paid to the defendant under protest and under duress, said sum of Seventy and 64/100 Dollars ($70.64).

Fifth. Thereafter and on or about the 24th day of July, 1914, the plaintiff duly appealed to the Commissioner of Internal Rev-
10 enue against the assessment and collection of said tax and demanded repayment of the amount so collected upon the ground that the said tax was erroneously and illegally assessed and collected for the reasons specified in its petition of appeal, and thereupon the said Commissioner overruled and denied the said appeal in all respects.

Sixth. The tax collected by the defendant from the plaintiff, as above described, was erroneously and illegally assessed and collected particularly in the following respects:

(1) Section 2 of said Act of Congress approved October 3, 1913, is unconstitutional and void because it is not a due exercise of the taxing power conferred by the Constitution upon Congress, because it involves the taking of property without due process of law and the taking of property for public use without compensation and because the classifications, discriminations and inequalities contained in said Act are arbitrary and have no reasonable relation to the production of revenue for the purposes of government, but are intended solely to regulate the conduct and affairs of the citizens and residents of the United States in respect to matters which are not within the powers delegated to Congress by the Constitution.

(2) Section 2 of the said Act approved October 3, 1913, insofar as it purports to tax the plaintiff and other corporations similarly situated not upon their actual net income, but upon a fictitious net income created for the purpose of taxation only by the application of artificial rules of computation, is not designed for the production of revenue, but is designed to regulate the internal affairs of such corporations in respect to the plan or method of capitaliza-
11 tion, and it thus involves an arbitrary classification of the persons subject to the tax having no reasonable relation to any power conferred upon Congress by the Constitution. In respect to

the application of the above-mentioned provisions of Section 2 to the affairs of the plaintiff, it is respectfully shown:

(*a*) The plaintiff paid in the year 1913 as interest upon its mortgage debt the sum of $13,750.00. The actual net income of the plaintiff for the year ending December 31, 1913, after deducting the interest actually paid upon its mortgage debt, its taxes and other expenses, was $564.26, upon which the normal tax of one per cent. would amount to $5.64. The tax actually exacted from the plaintiff under the terms of said Act of October 3, 1913, amounts to $70.64, being about twelve and one-half times the tax to which the plaintiff would have been subject if it had adopted the method or plan of capitalization which it was the obvious intention of Congress in enacting said Act of October 3, 1913, to make compulsory. The difference, $65.00, is in the nature of a penalty imposed upon the plaintiff for the year 1913 because its plan and method of capitalization were such as the laws of New York not only permit but actually favor and encourage. Moreover, this penalty is imposed by an ex post facto law, because the plaintiff could not anticipate prior to October 3, 1913, what the provisions of said Act would be in regard to regulating the capitalization of corporations and the greater part of said tax and penalty is imposed upon the plaintiff in respect to its supposed income prior to October 3, 1913.

12 (*b*) The actual value of the capital stock of the plaintiff for the year 1913 was assessed by the Comptroller of the State of New York at $57,300 and the plaintiff was taxed thereon accordingly. Had the nominal par value of the plaintiff's capital stock been equal to its actual value in said year, as so assessed, it would have been entitled in the computation of its taxable income to a deduction on account of interest amounting to $9,615 instead of the deduction of $7,250, which was all that was allowed to it under the terms of said Act of October 3, 1913, exacted from the plaintiff and the tax would have been only $46.99, instead of $70.64. The difference, $23.65, is in the nature of a penalty imposed upon the plaintiff because the nominal or par value of its capital stock is less than the actual value, although such method of capitalization is not only permitted but actually encouraged by the laws of the State of New York, which State alone possesses the right to regulate the organization and capitalization of the plaintiff.

(3) Section 2 of the said Act approved October 3, 1913, is not based upon any census or an enumeration made as required by the Constitution and is dependent for its validity upon the express authority given by the Sixteenth Amendment to the Constitution of the United States in relation to the taxation of income as such. The tax assessed against the plaintiff as aforesaid did not purport to be based upon any income received or accrued after the approval of said Act, but purported to be and in fact was based upon

13 the amount shown by the return of the plaintiff as its net income for the entire year ending December 31, 1913, of which said net income a large amount actually accrued to and was received by the plaintiff prior to October 3, 1913. At the time of the assessment of said tax there was no competent evidence before

the Commissioner of Internal Revenue that any income had accrued to or had been received by the plaintiff on or subsequent to October 3, 1913.

Wherefore, the plaintiff demands judgment against the defendant in the sum of Seventy and 64/100 dollars ($70.64), with interest from the 21st day of July, 1914, and the costs of this action.

DAVIES, AUERBACH & CORNELL,
*Attorneys for Plaintiff.*

Office & Post-Office Address: 34 Nassau Street, Borough of Manhattan, New York City.

STATE OF NEW YORK,
*City and County of New York, ss:*

Edwin Thorne, being duly sworn, deposes and says that he is the President of the Tyee Realty Company, the plaintiff above named; that he has read the foregoing complaint and knows the contents thereof; that the same is true of his own knowledge, except as to the matters therein stated to be alleged upon information and belief, and as to those matters he believes it to be true.

EDWIN THORNE.

Sworn to before me, this 9th day of November, 1914.

SAMUEL THORNE, JR.,
*Notary Public, Westchester County.*

Certificate filed in New York County.
Term expires March, 1916.

(Endorsed:) U. S. District Court, S. D. of N. Y. Filed Nov. 16, 1914.

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11362.

United States District Court, Southern District of New York.

L. 13/194.

TYEE REALTY COMPANY, Plaintiff,
v.
CHARLES W. ANDERSON, Defendant.

*Demurrer to Complaint.*

The defendant demurs to the complaint herein on the ground that, as appears upon the face thereof, it does not state facts sufficient to constitute a cause of action.

Dated: New York, February 2, 1915.

H. SNOWDEN MARSHALL,
*United States Attorney,*
*Attorney for Defendant.*

Office & Post Office address: U. S. Courts & P. O. Building, Borough of Manhattan, City of New York.

15 CITY OF NEW YORK,
*County of New York,* ss.:
*State of New York,*

Ben A. Matthews, being duly sworn, deposes and says that he is an Assistant United States Attorney for the Southern District of New York and as such has charge of the above-entitled case; that the above demurrer is not interposed for the purpose of delay, and that he verily believes that the complaint herein is bad in law.

BEN A. MATTHEWS.

Sworn to before me this 2nd day of February, 1915.

[SEAL.] FREDERICK D. CAMPBELL,
*Notary Public, Kings County, No.* 187.

Certificate Filed in New York County.
No. 61, New York County.
Register's No. 5164, New York County.
Register's No. 6178, Kings County.
My Commission Expires March 30, 1915.

(Endorsed:) Due service of a copy of the within is hereby admitted. New York, February 4, 1915. Davies, Auerbach & Cornell, Attorneys for Plaintiff.—U. S. District Court, S. D. of N. Y., Filed Feb. 5, 1915.

16 *Notice of Motion for Judgment.*

United States District Court, Southern District of New York.

L. 13—194.

TYEE REALTY COMPANY, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

SIR: Please take notice that on the complaint in the above entitled action and the demurrer interposed thereto, the undersigned will move this court at a stated term thereof, for the hearing of motions on the 11th day of February, 1915, at 10:30 o'clock in the forenoon of said day at the Post-office Building, Borough of Manhattan, City of New York, or as soon thereafter as counsel can be heard for judgment upon the pleadings herein and for such other and further relief as to the court may seem just and proper.

Yours, etc.,
DAVIES, AUERBACH & CORNELL,
*Attorneys for the Plaintiff.*

34 Nassau Street, New York City.

To H. Snowden Marshall, Esq., United States Dist. Attorney and Attorney for the Defendant, Post Office Building, Borough of Manhattan, New York City.

(Endorsed:) Copy Received. Feb. 6, 1915. H. Snowden Marshall, U. S. Attorney.—U. S. District Court, S. D. of N. Y., Filed Feb. 15, 1915.

17 At a Stated Term of the District Court of the United States of America for the Southern District of New York, Held at the United States Court Rooms, in the Borough of Manhattan, City of New York, on the 11th Day of February, 1915.

Present: Hon. Julius M. Mayer, Judge.

L. 13/194.

TYEE REALTY COMPANY, Plaintiff,
vs.
CHARLES W. ANDERSON, Defendant.

*Order Sustaining Demurrer.*

This cause having come on before me upon demurrer filed by the defendant to the complaint herein, and after hearing Ben A. Matthews, Assistant United States Attorney, in support of said demurrer, and Brainard Tolles in opposition thereto, and after due deliberation;

Now, upon motion of H. Snowden Marshall, United States Attorney, to sustain the demurrer and dismiss the complaint herein upon the ground that section 2 of the Act of Congress approved October 3, 1913, is in all respects constitutional and valid, it is

Ordered that the said demurrer be and the same hereby is in all respects sustained; and it is

Further ordered that the complaint herein be and the same hereby is dismissed; and it is

Further ordered that judgment on the merits be entered for defendant with costs.

J. M. MAYER,
*U. S. District Judge.*

Notice of Settlement waived.
Consented to as to form.
DAVIES, AUERBACH & CORNELL,
*Att'ys for Plaintiff.*

(Endorsed:) U. S. District Court, S. D. of N. Y. Filed Feb. 15, 1915.

18 *Judgment.*

United States District Court, Southern District of New York.

L. 12/194.

TYEE REALTY COMPANY, Plaintiff,
vs.
CHARLES W. ANDERSON, Defendant.

This cause having come on for hearing before the Honorable Julius M. Mayer, District Judge, upon the demurrer filed by the defendant to the complaint herein at a stated term held on the 11th day of February, 1915, and Ben A. Matthews, Esq., Assistant United States Attorney, appearing in support of said demurrer, and Brainard Tolles, Esq., in opposition thereto; and due deliberation having been had thereon and an order having been entered on the 15th day of February, 1915, wherein it was ordered that the complaint be dismissed with costs, and the costs having been taxed at the sum of Eighteen & 70/100 Dollars;

Now on motion of H. Snowden Marshall, Esq., United States Attorney for the Southern District of New York, attorney for defendant, it is adjudged that the defendant, Charles W. Anderson, herein, have judgment against the plaintiff, Tyee Realty Company, on the merits and that the defendant recover of the plaintiff the sum of Eighteen & 70/100 Dollars; and that defendant have execution therefor.

Judgment signed this 18th day of February, 1915.

ALEX. GILCHRIST, JR.,
*Clerk U. S. District Court.*

(Endorsed:) U. S. District Court, S. D. of N. Y., Filed Feb. 18, 1915, 4:00 P. M.

19 In the District Court of the United States for the Southern District of New York.

TYEE REALTY COMPANY, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

*Petition for Writ of Error.*

To the Honorable Judges of the District Court of the United States for the Southern District of New York:

The petition of Tyee Realty Company, the plaintiff herein, respectfully shows that on or about the 18th day of February, A. D., 1915, judgment was duly entered in this court in this cause in favor of the defendant and against the plaintiff dismissing the complaint,

in which judgment and the proceedings had prior thereto in this cause certain errors were committed to the prejudice of this plaintiff, all of which will more in detail appear from the assignment of errors which is filed with this petition.

Wherefore, this plaintiff prays that a writ of error may issue in this behalf out of the Supreme Court of the United States for the correction of the errors so complained of and that a transcript of the record, proceedings and papers in this cause duly authenticated may be sent to the Supreme Court of the United States.

DAVIES, AUERBACH & CORNELL,
*Attorneys for Plaintiff.*

(Endorsed:) U. S. District Court, S. D. of N. Y., Filed Feb. 24, 1915.

20 In the District Court of the United States for the Southern District of New York.

TYEE REALTY COMPANY, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

*Order Allowing Writ of Error.*

This 24th day of February, A. D., 1915, comes the plaintiff, by its attorney, and files herein and presents to the court its petition praying for the allowance of a writ of error and assignment of errors intended to be urged by it, praying also that a transcript of the record, proceedings and papers upon which the judgment herein was rendered, duly authenticated, may be sent to the Supreme Court of the United States and that such other and further proceedings may be had as are proper in the premises.

On consideration whereof the court does allow the writ of error upon the plaintiff's giving bond according to law in the sum of $250, which shall operate as a supersedeas bond.

J. M. MAYER, *D. J.*

(Endorsed:) U. S. District Court, S. D. of N. Y. Filed Feb. 24, 1915.

21 In the District Court of the United States for the Southern District of New York.

TYEE REALTY COMPANY, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

*Assignment of Errors.*

Now comes the plaintiff, Tyee Realty Company, and assigns errors in the trial and decision of this cause as follows:

First. The court erred in sustaining the demurrer of the defendant to the complaint herein.

Second. The court erred in holding that the complaint herein did not state facts sufficient to constitute a cause of action.

Third. The court erred in holding that Section 2 of the Act of Congress approved October 3rd, 1913, entitled "An Act to reduce tariff duties and to provide revenue for the government and for other purposes" is in all respects constitutional and valid.

Fourth. The court erred in holding that Section 2 of said Act of Congress approved October 3, 1913, is an exercise of the power conferred upon Congress by the Sixteenth Amendment to the Constitution to tax incomes from whatever source derived.

Fifth. The court erred in holding that Section 2 of the
22 said Act approved October 3, 1913, insofar as it purports to tax this plaintiff and other corporations similarly situated not upon their actual net income, but upon a fictitious net income created for the purpose of taxation only by the application of artificial rules of computation, is constitutional and valid.

Sixth. The court erred in holding that Section 2 of the said Act approved October 3, 1913, insofar as it attempts to regulate the internal affairs of corporations organized under the laws of the several States in respect to their plan or method of capitalization, is constitutional and valid.

Seventh. The court erred in holding that Section 2 of the said Act approved October 3, 1913, insofar as it imposes a penalty through disproportionate taxation upon this plaintiff because the nominal or face value of its capital stock is small in proportion to its mortgage debt, is constitutional and valid.

Eighth. The court erred in holding that Section 2 of the said Act approved October 3, 1913, insofar as it imposes a penalty upon this plaintiff through disproportionate taxation because the nominal or face value of its capital stock is small compared with the real value of its net assets, is constitutional and valid.

Ninth. The court erred in holding that Section 2 of said Act approved October 3, 1913, insofar as it purports to tax the income of the plaintiff received and expended or merged in the general assets of the plaintiff prior to the passage of said Act, is constitutional and valid.

Tenth. The court erred in dismissing the complaint and
23 in directing judgment in favor of the defendant upon the merits with costs.

Wherefore, plaintiff prays that the judgment of the said District Court may be reversed.

DAVIES, AUERBACH & CORNELL,
*Attorneys for Plaintiff.*

(Endorsed:) U. S. District Court, S. D. of N. Y., Filed Feb. 24, 1915.

24 Know all men by these presents, that we, Tyee Realty Company, as principal, and National Surety Company, as surety, are held and firmly bound unto Charles W. Anderson in the full and just sum of Two Hundred Fifty Dollars ($250), to be paid to the said Charles W. Anderson, his attorneys, executors, administrators or assigns; for which payment well and true to be made we bind ourselves, our heirs, executors, administrators and legal representatives jointly and severally by these presents.

Sealed with our seals this 23rd day of February in the year of our Lord One thousand nine hundred and fifteen.

Whereas, lately in the District Court of the United States for the Southern District of New York, in a suit depending in said court between Tyee Realty Company, plaintiff, and Charles W. Anderson, defendant, a judgment was rendered against the said Tyee Realty Company and said Tyee Realty Company having obtained a writ of error and filed a copy thereof in the Clerk's office of the said court to review the judgment in the aforesaid suit, and a citation having issued directed to the said Charles W. Anderson citing and admonishing him to be and appear at a session of the Supreme Court of the United States to be holden at the City of Washington on the — day of — next.

Now, the condition of the above obligation is such that if the said Tyee Realty Company shall prosecute said writ of error to effect and answer all damages and costs, if it fail to make its plea good, then the above obligation to be void, else to remain in full force and effect.

Sealed and delivered in the presence of:

[CORPORATE SEAL.] NATIONAL SURETY COMPANY,
By WM. A. THOMPSON,
*Resident Vice President.*

Approved by:

——— ———,
*U. S. District Judge.*

Attest:
N. V. TYNAN,
*Resident Ass't Secretary.*

25 TYEE REALTY COMPANY,
By JOHN N. GOLDING, *President.*

Attest:
THEO. G. BECKER,
[SEAL.] *Secretary.*

STATE OF NEW YORK,
*County of New York,*
*Southern District of New York, ss:*

On the 1st day of March, in the year One thousand nine hundred and fifteen, before me personally came John N. Golding, to me known, who, being by me duly sworn, did depose and say, that he

resides in The Borough of Manhattan, City of New York; that he is the President of the Tyee Realty Company, the corporation described in and which executed the above instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of said corporation, and that he signed his name thereto by the like order.

[NOTARIAL SEAL.] FRANK C. TITUS,
*Notary Public, New York County, No.* 3846.

3

New York County Register's No. 6003.
Commission Expires March 30, 1916.

Approved by:
C. M. HOUGH,
*U. S. District Judge.*

26 Capital $2,000,000.00.

*Affidavit, Acknowledgment, and Justification by Guarantee or Surety Company.*

STATE OF NEW YORK,
*County of New York, ss:*

On this 23rd day of February one thousand nine hundred and fifteen before me personally came Wm. A. Thompson, known to me to be the Resident Vice-President of the National Surety Company, the corporation described in and which executed the within and foregoing Bond of Tyre Realty Company, as a surety thereon, and who, being by me duly sworn, did depose and say that he resides in the City of New York, State of New York; that he is the Resident Vice-President of said Company, and knows the corporate seal thereof; that the said National Surety Company, is duly and legally incorporated under the laws of the State of New York; that said Company has complied with the provisions of the Act of Congress of August 13th, 1894; that the seal affixed to the within Bond of Tyre Realty Company, is the corporate seal of said National Surety Company, and was thereto affixed by order and authority of the Board of Directors of said Company; that he signed his name thereto by like order and authority as Resident Vice-President of said Company; that he is acquainted with N. V. Tynan and knows him to be the Resident Assistant Secretary of said Company; that the signature of said N. V. Tynan subscribed to said Bond is in the genuine handwriting of said N. V. Tynan, and was thereto subscribed by order and authority of said Board of Directors, and in the presence of said deponent; that the assets of said Company, unencumbered and liable to execution exceed its debts and liabilities of every nature whatsoever, by more than the sum of Two Million ($2,000,000) dollars.

That — is agent to acknowledge service for said Company in the Judicial District wherein this bond is given.

[CORPORATE SEAL.] WM. A. THOMPSON.
(Deponent's Signature.)

Sworn to, acknowledged before me, and subscribed in my presence this 23rd day of February, 1915.

[NOTARIAL SEAL.] H. E. EMMETT,
(Officer's Signature, Description, and Seal.)
*Notary Public for Kings County, No.* 3.

Certificate filed in New York County, No. 2, Nassau, Bronx, Queens, Richmond and Westchester Counties.
Kings County Register's Office No. 6802.
New York County Register's Office No. 6617.
Bronx County Register's Office No. 608.

(Endorsed:) U. S. District Court, S. D. of N. Y., Filed Mar. 2, 1915.

27 B. T.

UNITED STATES OF AMERICA, *ss*:

To Charles W. Anderson, Greeting:

You are hereby cited and admonished to be and appear at the Supreme Court of the United States to be holden at the City of Washington on the 23rd day of March next, pursuant to a writ of error filed in the Clerk's office of the District Court of the United States for the Southern District of New York, wherein Tyee Realty Company is plaintiff and you are defendant in error, to show cause, if any there be, why the judgment rendered against the said plaintiff in error as in said writ of error mentioned should not be corrected and speedy justice be done to the parties in that behalf.

Given under my hand at the City of New York in the district above named this 24th day of February, in the year of our Lord One thousand nine hundred and fifteen.

J. M. MAYER,
*Judge of the District Court of the United States for the Southern District of New York.*

A. G., JR.

28 [Endorsed:] A copy of the within paper has been this day received at this office, Feb. 23, 1915. H. Snowden Marshall, U. S. Attorney. Service of a copy of the within citation is hereby admitted this 24th day of February, 1915. ————, United States District Attorney and Attorney for Defendant in Error. L. 13—194. Dist. Court of the U. S., Southern Dist. of N. Y. Tyee Realty Company, Plaintiff, against Charles W. Anderson, Defendant. (Original.) Citation. Davies, Auerbach & Cornell, Attorneys for Plaintiff Mutual Life Building, 34 Nassau Street, New York City. U. S. District Court, S. D. of N. Y. Filed Feb. 24, 1915. .10. K.

29 United States District Court, Southern District of New York.

L. 13—194.

TYEE REALTY COMPANY, Plaintiff,
vs.
CHARLES W. ANDERSON, Defendant.

It is hereby stipulated and agreed that the Record on Appeal in the above entitled action to the Supreme Court of the United States shall consist of the following papers, to wit:

Summons
Affidavit of Service of Summons
Complaint
Demurrer to Complaint
Notice of Motion for Judgment
Order sustaining demurrer
Judgment
Petition for Writ of Error
Assignment of Errors
Bond on Appeal
Order allowing Writ of Error
Writ of Error
Citation

and may be so certified by the Clerk of the United States District Court for this District.

Dated March 2, 1915.

DAVIES, AUERBACH & CORNELL,
*Attorneys for Plaintiff.*
H. SNOWDEN MARSHALL,
*U. S. Attorney,*
*Attorney for Defendant.*

[Endorsed:] United States Supreme Court. Tyee Realty Company, Plaintiff in Error, ag'st Charles W. Anderson, Defendant in Error. Transcript of Record. Error to the District Court of the United States for the Southern District of New York.

Endorsed on cover: File No. 24,612. S. New York D. C. U. S. Term No. 868. Tyee Realty Company, plaintiff in error, vs. Charles W. Anderson, Collector of Internal Revenue. Filed March 12th, 1915. File No. 24,612.

9

# Supreme Court of the United States,

OCTOBER TERM, 1915.

No. 393.

TYEE REALTY COMPANY,
*Plaintiff-in-Error,*

*against*

CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE,
*Defendant-in-Error.*

## BRIEF FOR PLAINTIFF-IN-ERROR.

JULIEN T. DAVIES,
BRAINARD TOLLES,
GARRARD GLENN,
Walter A. Schmidt

*Of Counsel.*

The Evening Post Job Printing Office, Inc., 156 Fulton St., N. Y.

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# Supreme Court of the United States,

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## BRIEF FOR APPELLANT.

This case comes before this Court upon a writ of error to the District Court of the United States, for the Southern District of New York. The Tyee Realty Company, the plaintiff in error, sued Charles W. Anderson, as Collector of Internal Revenue, in the District Court of the United States to recover the sum of $70.64, with interest from the 21st day of July, 1914, with costs, being the amount claimed to have been paid by the plaintiff to the defendant under protest and under duress, on the 21st day of July, 1914, as an alleged income tax assessed upon the plaintiff by the Commissioner of Internal Revenue for the period from March 1, 1913, until January 1, 1914.

The complaint was demurred to, and a motion was made to dismiss the complaint, and judgment was given to the defendant against the plaintiff in error upon the merits, together with the sum of

$18.70 as costs (Rec., fol. 18), whereupon the plaintiff in error sued out a writ of error, which was duly allowed (Rec., fol. 11), and duly assigned errors in the trial and decision of the cause (Rec., fol. 12).

## Statement of Facts.

This case raises the question of the validity of so much of Section 2 of the Act of October 3d, 1913, as provides that in the taxation of a corporation there is to be deducted from its gross income, not the total amount of interest paid within the year upon its indebtedness which is allowed to be deducted in the case of an individual taxpayer, but only an amount of interest paid by the corporation on a sum equal to one-half of its indebtedness bearing interest augmented by the par value of its capital stock.

The complaint states that the plaintiff is a corporation organized under the laws of New York, with its principal place of business in New York City. The business for which it is organized, and the only business which it has ever conducted, is holding real property in the State of New York for investment. It was incorporated in 1906, under the Business Corporations Law of New York, with an authorized capital stock of $10,000, all of which is now outstanding and fully paid. It purchased certain real estate in New York City, subject to indebtedness secured by mortgage, amounting at first to $150,000, which was later increased to $275,000. Its total indebtedness outstanding on December 31, 1913, was $270,000, being all mortgage indebtedness as above stated, $5,000 of its indebtedness having been paid off on October 7, 1913. We have, then, the case of a New York corporation whose operations are entirely confined to New York and whose property is situated in New York, with an authorized capitali-

zation of $10,000, and a mortgage debt of $270,000 (Rec., p. 3).

The complaint explains the circumstances attendant upon this situation. The plaintiff, it states, was capitalized wholly by means of mortgage indebtedness. This, it alleges, was in accordance with the public policy of New York State as embraced in its tax laws. These laws are so framed as to encourage, in the case of real estate companies, the capitalization of the enterprise by a large amount of mortgage bonds and a relatively small capital stock. This is indicated by the following provisions of New York's tax laws:

(*a*) Mortgage indebtedness is taxed only once by means of a recording tax at the rate of one-half of one per cent. of the principal of the mortgage debt; and in consideration of the payment of this tax the mortgage debt is exempt from taxation thereafter so long as the mortgage or any extension thereof continues in force, leaving the annual tax upon this form of capitalization equal to the legal interes upon the amount paid as the recording tax, or .0003.

(*b*) The annual tax upon capital stock required to be paid by the State Comptroller is .003/4.

(*c*) The organization tax of New York is proportioned to the par value of the capital stock and not to its actual value.

(*d*) The tax in New York upon personal property is assessed upon its value after deducting therefrom all the taxpayer's outstanding indebtedness.

The complaint alleges that these provisions of the New York laws from part of a system of taxation adopted as a result of many years of experiment and discussion, whereby direct taxes for

state purposes have been practically eliminated, and equalization of taxation has been effected between all the different sections of the state. By this system of taxation, an inducement has been given to corporations designed to do business in New York, to organize themselves under the laws of that state, as distinguished from other states, and also the practice of real estate corporations of issuing large volumes of stock for speculative purposes has been discouraged. All of this has been the result of the best judgment of those who have from time to time been charged with the duty of determining the legislative policy of New York State (Rec., p. 4).

The complaint then states that under the present Income Tax Law the Commissioner of Internal Revenue assessed upon the plaintiff's alleged income for the ten months of 1913 a tax of seventy dollars and sixty-four cents ($70.64). Thereafter notice of such assessment was given to the plaintiff and a demand made upon it by the defendant for the payment of the tax on or before June 30, 1914, in order to avoid penalty and interest. A further notice having been served upon the plaintiff about July 15, 1914, accompanied by a threat to distrain the plaintiff's property if the tax were not paid within ten days, the plaintiff on July 21, 1914, paid the tax to the defendant under protest and duress. On July 24, 1914, the plaintiff appealed to the Commissioner of Internal Revenue against the assessment and collection of the tax, and demanded repayment of the same upon the ground that the tax was erroneously and illegally assessed and collected. The Commissioner denied this appeal. The plaintiff then alleges that this tax was erroneously and illegally assessed and collected, particularly in the respects then enumerated, which may be reduced to the following: The statute does not tax the plaintiff or any other corporation so situated upon its

real net income. On the contrary, it imposes the tax upon a fictitious net income created, for the purposes of taxation only, by the application of artificial rules of computation. In 1913 the plaintiff paid $13,750 as interest on its mortgage debt. Its actual net income for that year after deducting this interest, its taxes and other expenses, was $564.26. A normal tax of one per cent. upon the company's net income would be $5.64. The tax actually exacted from the plaintiff under the terms of the income tax law amounts to twelve and one-half times that figure. The difference, the bill alleges, is in the nature of a penalty imposed upon the plaintiff for the year 1913, because its plan and method of capitalization was such as the laws of New York not only permit, but actually favor and encourage. In addition, this penalty is imposed by an *ex post facto* law. Prior to the actual passage of the act, the plaintiff could not anticipate what its provisions would be in regard to regulating the capitalization of corporations. The greater part of this tax and penalty is imposed upon the plaintiff in respect to its supposed income prior to October 3, 1913. The complaint also alleges that the actual value of the plaintiff's capital stock for 1913 was assessed by the Comptroller of New York State at $57,300, and the plaintiff was taxed thereon accordingly. If the nominal par value of the plaintiff's capital stock had been equal to its actual value in that year as so assessed, it would have been entitled, in the computation of its taxable income, to a deduction on its income amounting to nine thousand six hundred fifteen dollars ($9,615) instead of the deduction of seven thousand two hundred and fifty dollars ($7,250), which was all that was allowed to it under the Income Tax Law, and the tax would have been only forty-six dollars and ninety-nine cents ($46.99) instead of seventy dollars and sixty-four cents ($70.64). The

difference of twenty-three dollars and sixty-five cents ($23.65) is in the nature of a penalty imposed upon the plaintiff because the par value of its capital stock is less than its actual value, although such method of capitalization is not only permitted, but actually encouraged by the laws of New York.

The complaint then alleges that the Income Tax Law depends for its validity on the Sixteenth Amendment to the Constitution, relating to the taxation of income as such. The tax assessed against the plaintiff did not purpose to be based on any income received or accrued after the passage of the act, but purported to be, and in fact was, based on the amount computed by the Commissioner as its taxable income for ten months of the year ending December 31, 1913, *of which income a large amount actually accrued to and was received by the plaintiff prior to October 3, 1913.* At the time the tax was assessed there was no competent evidence before the Commissioner of Internal Revenue that any income had accrued to the plaintiff or been received by it subsequent to October 3, 1913.

The complaint demands judgment for the return of the tax paid, with interest and costs.

## Specification of Errors.

1. The Income Tax Law of 1913 in its application to the plaintiff in this case is not an exercise of the power conferred upon Congress by the Sixteenth Amendment to tax "incomes from whatever source derived."

2. The law purports to tax the plaintiff, not upon its actual net income, but upon a fictitious net income created for the purposes of taxation only by applying artificial rules of computation and by allowing plaintiff as a deduction from its gross

income, not the interest paid by it during the year, but only the interest paid upon one-half of its interest bearing indebtedness augmented by the par value of its capital stock.

3. The law attempts to regulate the internal affairs of corporations organized under the laws of the several States in respect to their plan or method of capitalization.

4. The law, through disproportionate taxation, imposes a penalty upon the plaintiff because the nominal or face value of its capital stock is small in proportion to its mortgage debt.

5. The law, through disproportionate taxation, imposes a penalty upon the plaintiff because the nominal or face value of its capital stock is small compared with the real value of its net assets.

6. The law purports to tax the plaintiff's income received from March 1, 1913, to October 3, 1913, which necessarily has been expended or merged in its general assets prior to the passage of the act (Rec., p. 12).

## POINT FIRST.

**The effect of the Sixteenth Amendment was merely to waive the requirement of apportionment among the states in its application to a general and uniform tax upon incomes from whatever source derived. The Income Tax Law of 1913, except insofar as the tax thereby imposed is in reality such a general and uniform tax on incomes, derives no support from the Sixteenth Amendment.**

Our views in regard to the scope and meaning of the Sixteenth Amendment in the light of its history are presented in the First Point of our brief in *Brushaber* vs. *Union Pacific Railroad Company*, No. 140 on this calendar, to which, in order to avoid repetition, we beg leave to refer.

## POINT SECOND.

**So much of Section 2 of the Act of October 3rd, 1913, as limits the interest which may be deducted in ascertaining the taxable income of a corporation, to the interest accrued and paid within the year, upon an amount of indebtedness not exceeding one-half of the sum of its interest bearing indebtedness and its paid-up capital stock, is invalid.**

The most important question presented by this case of *Tyee Realty Company* vs. *Collector* arises

out of the fact that by the necessary operation of the Income Tax Law the plaintiff is not taxed on its net income but upon a fictitious income created for the purpose of taxation only by the application of artificial rules of computation.

The plaintiff has an authorized capital stock of $10,000. It owns real estate in New York City subject to mortgage indebtedness aggregating $270,000. In 1913 it paid $13,750 as interest upon its mortgage debt. Its actual net income after deducting the interest thus paid, its taxes and other expenses, was $564.26. Upon this its normal tax would amount to $5.64. The tax actually exacted from the plaintiff was $70.64, being based upon a fictitious income of $7,064, which was computed for the purpose of taxation only by applying the limitation embodied in the statute. The reason for the excessive assessment was the provision of the statute which forbids a corporation to deduct from its gross income more than " the amount of interest accrued and paid within the year on its indebtedness not exceeding one half of the sum of its interest bearing indebtedness and its paid up capital stock outstanding at the close of the year." An individual income taxpayer is allowed to deduct from his gross income all interest actually paid during the year upon his indebtedness.

This one instance suffices to show that the present law does not in all cases tax net income. If it had not specified the deductions to be allowed from gross income, there is no doubt that the plaintiff would have been able to deduct from its gross income the amount of interest paid on its indebtedness in full. But as the law specified the deductions and forbids the corporation from making the present deduction, the result is a tax upon the corporation's gross income to a degree instead of its net income.

**The discrimination is unwarranted by the Sixteenth Amendment.**

The Sixteenth Amendment confers power upon Congress only to tax incomes from whatever source derived. This power necessarily is limited to the taxation of net incomes. Gross income or receipts not diminished by the outgoes of the period taken are not incomes in a true sense. Such amounts are greater than the income or the net income of the taxpayer. It is obvious that if a corporation in computing its income for the purpose of taxation is not allowed to deduct all interest paid upon all of its indebtedness during the period of computation, its taxation will be not of income or of net income but of its gross income, diminished to be sure, by some deductions but not by all of the deductions that would bring it down to income or net income. There is therefore from the operation of the statute a clear discrimination or classification made between corporations which have either no indebtedness, or indebtedness one-half of which does not exceed the par value of their capital stocks, and are therefore taxed upon their incomes or net incomes and corporations which by reason of the smallness of their capital stock in comparison with one-half of their indebtedness, are taxed upon their gross incomes, partially diminished but not so far diminished as to be income or net income. This discrimination or classification is unreasonable, and is founded upon no reason that bears a just relation to the subject matter, for a difference in the amount of the indebtedness of corporations furnishes no real distinction between them for purposes of classification for taxation.

This part of the statute can be declared invalid without affecting the scheme of taxation as a whole with the result that all corporations can remain in the same class of being taxed upon their actual in-

come. It is also obvious that the effect of that part of the statute here complained of is to discriminate against the corporations thus regulated in favor of individuals who are permitted to deduct the interest upon all their indebtedness in arriving at their net incomes.

It is our contention that the discrimination herein complained of is unconstitutional and void for the following reasons:

(1) The tax imposed by the statute in so far as it exceeds the normal tax of one per centum upon the actual net income of the plaintiff, being directly based upon the returns from the plaintiff's real property is a direct tax and and yet not an income tax within the meaning of the Sixteenth Amendment; consequently it is void for lack of apportionment.

(2) The classification upon which the discrimination is based is so arbitrary and unreasonable as to involve the taking of the property of the plaintiff without due process of law.

(3) The classification upon which the discrimination is based turns upon differences having no relation to any matter within the jurisdiction or control of Congress. Our argument under this latter proposition is presented in the second point of our brief in *Brushaber* vs. *Union Pacific Railroad Company*, No. 140 on the present Calendar, to which, in order to avoid repetition, we beg leave to refer.

**The tax does not rest upon income in the true sense of the word.**

The necessary result of this statute is that any corporation whose capital stock is exceeded by one-

half of its mortgage indebtedness, pays to some extent a tax upon its gross income instead of its net income. Such a statute does not impose an income tax within the meaning of the Sixteenth Amendment. The amendment, allowed a tax "on incomes from whatever source derived." This provision must be read in the light of history and precedent. Judged by them, there is no such thing as an income tax unless it is a tax upon net income. Gross income is not income in any sense of the word. It is not an object of taxation, and never was in any civilized government. Any Statute providing for an income tax, of necessity means a tax upon net incomes.

The Sixteenth Amendment authorizes a direct tax without apportionment only in so far as that tax is on income. Any direct tax beyond this must still be apportioned.

But to tax as income an amount which is made up of the sum of what is really income in its accepted sense, plus interest paid by a corporation on its indebtedness, is taxing the corporation's property that has produced this interest on its indebtedness which interest, although part of gross income, is outgo and not "income," and this clearly unauthorized under the Amendment. This is not a question of the intention of Congress but of the intention evidenced in the Sixteenth Amendment by the use of the word "income". It would have been easy, were such the purpose, entirely to abrogate the constitutional provision that direct taxes be apportioned. But the fact that a word of limited meaning has been used, added to the fact that the constitutional provision in regard to apportionment is an important safeguard and restriction on Congress, must lead to the conclusion that the abrogation was intended to be limited to a tax on income in the accepted sense of that word.

There can be no reasonable doubt as to the accepted meaning of the word "income."

In *Thompson* v. *Redding* [1897], 1 Ch. 876, at 879, the Court said:

> "What is 'income derived from them'? It appears to me that it is not the whole income which would be derived from these leaseholds without any deduction, but the income after making proper deductions in respect to these charges. 'Income derived', in ordinary parlance, is construed to mean, not the gross rents, but the rents after deducting all proper outgoings."

The cases in this country are to the same effect.

In *Peck* v. *Kinney*, 143 Fed. 76, the Circuit Court of Appeals of the Second Circuit in a case involving taxation under the War Revenue Act of June 13, 1898, at page 80 said:

> "There is this distinction between income and an annuity. The former embraces only the net profits after deducting all necessary expenses and charges; the latter is a fixed amount directed to be paid absolutely and without contingency."

In an opinion rendered the House of Representatives of the Commonwealth of Massachusetts (46 Mass. 596) the Justices (among whom was Mr. Chief Justice LEMUEL SHAW), at 598 said:

> "We are not quite certain that we understand precisely what is intended by the 'gross income' of the corporation, and what by the 'net income'. But we suppose that in any mode of estimating the income of the corporation, the expenses of the necessary repairs, and also of maintaining and employing engines and cars, for the carriage of passengers and freight, and all other necessary and incidental expenses of management, must be deducted from the actual receipts. *Such balance only can be regarded as the income of the corporation.*"

In *Poland* v. *Railroad Co.*, 52 Vt. 144, the Court at 177 said:

> "Income means what is left after paying the expenses of earning income."

In *Andrews* v. *Boyd*, 5 Me. 199, the Court at page 203 said:

> "The income of an estate means nothing more than the profit it will yield after deducting the charges of management, or the rent which may be obtained for the use of it. *The rents and profits of an estate, the income, or the net income of it, are all equivalent expressions.*"

The same proposition has been established by a series of decisions of the English and Canadian courts, which was familiar to American lawyers long prior to the adoption of the Sixteenth Amendment.

*Lawless* v. *Sullivan* (L. R., 6 App. Cas. 373);

*City of Kingston* v. *Canada Life Assurance Co.* (19 Ont. 453);

*Taxation Commissioners* v. *Antill* (L. R., 1902 App. Cas. 422).

In *Lawless* v. *Sullivan* (*supra*), the Privy Council, speaking through SIR MONTAGUE E. SMITH, said:

> "There can be no doubt that, in the natural and ordinary meaning of language, the income of a bank or trade for any given year would be understood to be the gain, if any, resulting from the balance of the profits and losses of the business in that year. That alone is the income which a commercial business produces, and the proprietor can receive from it. The question is, whether the word 'income' in the enactment to be construed is to be understood in a different, and what, for the purpose of taxation, would be a more onerous sense. It was not and could not be contended on behalf of the assessors that 'in-

come' in the enactment meant all the takings or moneys received by a bank or in a trade from customers or otherwise; and it was not denied that it meant profits, in some sense of the word. The contention, as their Lordships understood it, was that the items of profit should be selected from the accounts, and the aggregate of these items treated as being the income of the year. * * * The intention of the Legislature should be very clearly shown to justify an interpretation of the word 'income' which would require that, in the account for the year, the items of profit only should be included, and the losses excluded, although, but for the operations which occasioned the losses, the apparent profits could not have been made."

*Lawless* v. *Sullivan* (L. R. 6 App. Cas. 373, 378, 9).

In *City of Kingston* vs. *Canadian Life Assurance Company* (*supra*) the income tax law of the Province of Ontario imposed simply a tax upon income. The Court followed *Lawless* v. *Sullivan* (*supra*), holding that by that the Legislature intended only a tax upon net income. CHANCELLOR BOYD said:

"The matter of the taxation of corporations has arisen and is receiving very special attention in the different States of the adjoining republic, and in many of them the system of levying taxes on gross receipts for premiums and other like sources of income has been adopted. Our statute does not make any plain distinction between income tax properly so-called and a rate levied upon personal property though these are becoming badly contrasted by social economists. The assessments here imposed were in respect of income only and not in respect of personal property or of income and personal property. The distinction is, I think, material in view of the application of the Statute as it is framed 'Income' is not perhaps the most appropriate word to use with reference to corporations, but,

being used for convenience or for comprehensiveness, it must receive the same meaning which 'income' has in connection with individuals or partnerships." (Then the court after discussing *Lawless* v. *Sullivan* (*supra*) continues): "The judgment, then, is definite and conclusive upon this point, that 'income' as commercially used, means the balance of gain over loss in the fiscal year or other period of computation * * * I see nothing to detract from the ordinary commercial meaning attributable to the word 'income' as defined by the highest appellate tribunal of this country."

*City of Kingston* v. *Canadian Life Assurance Company* (19 Ont. 453, 457–8).

In the words of LORD MACNAGHTEN, the English Income Tax Law has this meaning alone: It never imposes a tax upon property. "It is as a source of income that the Act contemplates and deals with property" (*Colquhoun* v. *Brooks*, L. R. 14 A. C. 493, 516).

This distinction is further emphasized by the Privy Council in *Taxation Commissioners* v. *Antill* (*supra*). There an Australian statute imposed two taxes, a land tax and an income tax. The question was whether as to income, the respondent could deduct the fair value of land owned by him. The statute allowed certain deductions as to land values and this was not one of them. It was held that the deduction was not allowable, but it was intimated that if this had been an income tax, the question of deduction would be material as bearing upon the net income. LORD MACNAGHTEN said:

"Instead of collecting income tax by separate returns under different schedules of charge, as is the case under the income tax code in force in this country, the Act of 1895 in force in New South Wales first imposes a land tax upon all lands in the state with certain exceptions and then requires inclusive returns of all

> income arising from any property in the state except from land subject to land tax."
>
> *Taxation Commissioners* v. *Antill* (1902 App. Cas. 422, 428).

The only case that can be found where "income" was allowed to mean gross income, is *People* v. *Supervisors* (4 Hill 20), but there the statute imposed a tax upon a corporation 's capital stock. The tax was laid on all corporations "deriving an income *or* profit from their capital or otherwise." "Income," being set off against "profit," was construed as meaning gross income, as distinct from profit which meant net income.

Instances of taxes on gross receipts are common, but they are not and never have been called income taxes. Examples of such taxes have been before this court many times in cases ranging from *State Tax on Railway Gross Receipts* (15 Wall. 284) through *Philadelphia Steamship Company* v. *Pennsylvania* (122 U. S. 326) to *Maine* v. *Grand Trunk Railway* (142 U. S. 217). But as CHANCELLOR BOYD pointed out in the Canadian case above cited, such a tax as that is not an income tax and belongs in quite a different category. The so-called income tax laws imposed by Congress during the Civil War, it is true, allowed only certain deductions much in the manner of the present statute. But these statutes are not instructive from the present view point. This court solemnly determined that they did not impose an income tax on a holder of stocks or bonds of the corporation upon which the tax was laid, "but on the earnings of the corporations which pay the interest" (*Railroad Company* v. *Collector*, 100 U. S. 595). In *Little Miami Railroad* v. *United States* (108 U. S. 277) this court determined that the tax was imposed upon the profits of companies, and that

these profits meant "profits of the company in its business as a whole, that is to say, the excess of the aggregate of gains from all sources, over the aggregate of losses." Later this court held that the tax thus laid was an excise tax upon the business conducted by the corporation, and not a tax upon the bondholder or stockholder (*United States* v. *Erie Railroad Company*, 166 U. S. 327).

The Income Tax Law of 1894 forms no criterion, because it allowed as a deduction "the amount paid on account of interest, annuities and dividends." The Excise Tax Act of 1909 furnishes no criterion because it also allowed the deduction of indebtedness in full. It remained for the present act to make the distinction now complained of.

**The classification is arbitrary and unreasonable.**

To allow as deductions to individuals all interest paid within the year by such individuals on indebtedness, and to allow to certain corporations such a deduction, but to refuse the complete deduction to corporations one-half of whose indebtedness exceeds their authorized capital stock, constitutes against such corporations not only a taxing of what is not properly income but an arbitrary discrimination. Such exercise of taxing power transcends the constitutional limitations. For although one of the limitations upon the power of Congress has been abrogated by the Sixteenth Amendment so long as the subject taxed is income, nevertheless even within this subject, its powers are not without limit.

The idea of uniformity enters into the very definition of a tax. Cooley on Taxation, Third Edition, Volume 1, page 1, says:

> "Taxes are the enforced proportional contributions from persons and property levied by

> the state by virtue of its sovereignty for the support of the government and for all public needs."

And at page 4:

> "They differ from the enforced contributions, loans and benevolencies of arbitrary and tyrannical periods in that they are levied by authority of law and by some rule of proportion which is intended to insure uniformity of contribution and a just apportionment of the burdens of government."

Under our form of government this is an essential feature of taxation and constitutes a limitation upon the taxing power of Congress.

Gray, Limitations on Taxing Power, page 353:

> "The view established by authority is that the words as used in the Constitution refer to geographical uniformity. It is not intended by this to say that Congress can lay indirect taxes violative of all the principles of equality and uniformity as between persons. Congress *is* limited in this regard; but its limitations are derived not from the words 'uniform throughout the United States', but from the general nature of all legislative power to tax, from the inherent elements of uniformity and equality which partly make up the concepts of taxation and taxes. The restrictions upon Congress in this regard arise from the very nature of legislative power as a power held in trust for the whole people."

Cooley, Constitutional Limitations, pages 607, 615:

> "In the second place it is of the very essence of taxation that it be levied with equality and uniformity, and to this end that there should be some system of apportionment. Where the burden is common there should be a common contribution to discharge it. Taxation is the equivalent for the protection which the govern-

ment affords to the persons and property of its citizens; and as all are alike protected, so all alike should bear the burden. * * * Whatever may be the basis of taxation, the requirement that it shall be uniform is universal."

This principle has been many times recognized in this Court.

In *M'Culloch* v. *Maryland*, 4 Wheat. 316, Mr. Chief Justice MARSHALL at page 435 said:

> "The people of all the states and the states themselves are represented in Congress and by their representatives exercise this power. When they tax the chartered institutions of the states, they tax their constituents, *and these taxes must be uniform.*"

See also

*Loan Assn.* v. *Topeka*, 20 Wall. 655 at 663;
*United States* v. *Singer*, 15 Wall. 111 at 121;
*Scholey* v. *Rew*, 23 Wall. 331 at 348;
*Ward* v. *Maryland*, 12 Wall. 418 at 431.

In *Loughborough* v. *Blake*, 5 Wheat. 317, Mr. Chief Justice MARSHALL, speaking of the power of Congress to impose a direct tax within the District of Columbia, at page 325, said:

> "If it be said that the principle of uniformity established in the Constitution secures the District from oppression in the imposition of indirect taxes, it is not less true that the principle of apportionment also established in the Constitution secures the District from any oppressive exercise of power to lay and collect direct taxes."

In *Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S. 429, it was contended that the statute was void for lack of uniformity. The Court, summarizing the contention, at page 555, said:

> "Under the second head it is contended that the rule of uniformity is violated in that the

> law taxes the income of certain corporations, companies and associations, no matter how created or organized, at a higher rate than the incomes of individuals or partnerships derived from precisely similar property or business; * * * these and other exemptions being alleged to be purely arbitrary and capricious justified by no public purpose and of such magnitude as to invalidate the entire enactment."

The Court, at page 586, stated that inasmuch as the Justices who heard the argument were equally divided upon the question whether the tax was invalid for want of uniformity, no opinion was expressed on that subject. Mr. Justice FIELD, however, in his concurring opinion, at page 594, said:

> "The object of this provision (of uniformity) was to prevent unjust discrimination. *It prevents property from being classified and taxed as classed by different rules.* All kinds of property must be taxed uniformly or be entirely exempt. The uniformity must be co-extensive with the territory to which the tax applies.
>
> Mr. Justice MILLER in his Lectures on the Constitution (N. Y. 1891) pages 240, 241, said of taxes levied by Congress: 'The tax must be uniform on the particular article; and it is uniform within the meaning of the constitutional requirement if it is made to bear the *same percentage* over all the United States. That is manifestly the meaning of this word as used in this clause. The framers of the Constitution could not have meant to say that the government in raising its revenues should not be allowed to discriminate between the articles which it should tax.' In discussing generally the requirement of uniformity found in state constitutions he said: 'The difficulties in the way of this construction have, however, been very largely obviated by the meaning of the word "uniform" which has been adopted holding that the uniformity must refer to articles

of the same class. *That is different articles may be taxed at different amounts provided the rate is uniform on the same class everywhere with all people and at all times.* * * *'

" Exemptions from the operation of a tax always create inequalities. Those not exempted must in the end bear an additional burden or pay more that their share. A law containing arbitrary exemptions can in no sense to termed uniform. * * * Where property is exempted from taxation the exemption, as has been justly stated, must be supported by some consideration that the public and not private interests will be advanced by it. Private corporations and private enterprises cannot be aided under the pretense that it is in the exercise of the discretion of the legislature to exempt them."

And further at page 596:

" Whenever a distinction is made in the burdens a law imposes or in the benefit it confers on any citizens by reason of their birth or wealth or religion, it is class legislation and leads inevitably to oppression and to general unrest and disturbance in society. It was hoped and believed that the great amendments to the Constitution which followed the late Civil War had rendered such legislation impossible for all future time."

And at page 599:

" There are other considerations against the law which are equally decisive. They relate to the uniformity and equality required in all taxation, national and state; * * *

" As stated by counsel, 'There is no such thing in the theory of our national government as unlimited power of taxation in Congress.' There are limitations as he justly observes, of its powers arising out of the essential nature of all free governments. There are reservations of individual rights without which society could

not exist and which are respected by every government. The right of taxation is subject to these limitations (citing cases).

"The inherent and fundamental nature and character of a tax is that of a contribution to the support of the government levied upon the principle of equal and uniform apportionment among the persons taxed and any other exaction does not come within the real definition of a tax.

"This inherent limitation upon the taxing power forbids the imposition of taxes which are unequal in their operation upon similar kinds of property and necessarily strikes down the gross and arbitrary distinctions in the income law as passed by Congress.

In *Southern Railway Company* v. *Greene*, 216 U. S. 400, it was held that a statute which classified separately domestic and foreign corporations for the purpose of taxation and imposed a greater franchise tax upon foreign corporations than that imposed upon domestic corporations was an arbitrary selection, and could not be justified by calling it classification in the absence of real distinction of a substantial basis. The Court said:

"While reasonable classification is permitted without doing violence to the equal protection of the laws, such classification must be based upon some real and substantial distinction bearing a reasonable and just relation to the things in respect to which such classification is imposed, and cassification cannot be arbitrarily made without any substantial basis. Arbitrary selection, it has been said, cannot be justified by calling it classification. (*Gulf, Colorado & Santa Fe Ry.* v. *Ellis*, 165 U. S. 150, 155, 165; *Cotting* v. *Kansas City Stockyards Co.*, 183 U. S. 79; *Connolly* v. *Union Sewer Pipe Co.*, 184 U. S. 540, 559.)"

While the case above cited arose under the Fourteenth Amendment to the Constitution of the United

States, and while it was held that the complaining corporation was a citizen within the jurisdiction of the State of Alabama and entitled to the equal protection of its laws under that amendment, the case is an additional authority to many in this Court upon the proposition that while a legislative body possesses great powers in classifying subjects of taxation and imposing different rates of taxation upon different classes of subjects, the action of the legislature must be classification and not arbitrary selection. It is well said that the object of the Fourteenth Amendment was "to prevent any person or class of persons from being singled out as a special subject for discrimination and hostile legislation" (*Pembina Mining Co.* v. *Pennsylvania*, 125 U. S. 181, 188), but the principle of the Fourteenth Amendment that prevents this discriminating and hostile legislation is found in the implied limitations of the Constitution of the United States upon the taxing power of Congress. The power that is given to Congress is to levy and collect taxes, and amounts sought to be collected by legislation by the process of arbitrary selection and not by that of classification are not taxes, but arbitrary exactions and beyond the power of Congress to enforce. It has been frequently held that, notwithstanding the language of the Fourteenth Amendment in its guarantee of equal protection of the laws is not to be found in the Constitution of the United States, that its principle is an implied limitation on the powers of Congress, and that the Constitution of the United States by implication requires Congress to see to it that in its legislation the citizens of the United States receive the equal protection of the laws of the United States.

That this implied limitation on the power of Congress is transcended by decreeing that the amount of the tax be figured in one manner when levied upon an individual and in another when levied upon

a corporation whose indebtedness exceeds its authorized capital stock, is clear. To grant individuals a deduction for indebtedness but to deny such deduction to the same extent to corporations is capricious and arbitrary.

In *County of Santa Clara* v. *Southern Pacific R. Co.*, 18 Fed. 385 (aff'd 118 U. S. 394), Justice FIELD held that a tax law which discriminates between the assessment for taxation of the property of a corporation and of the property of individuals, giving individuals an exemption not granted to the corporation, was unconstitutional. The Act therein concerned declared that a mortgage, deed of trust, contract or other obligation should for the purposes of assessment and taxation be deemed an interest in the property affected thereby, and provided:

> "*Except as to railroad and other quasi public corporations* in case of debts so secured, the value of the property affected by such mortgage, deed of trust, contract or obligation, less the value of such security, shall be assessed and taxed to the owner of the property and the value of such security shall be assessed and taxed to the owner thereof."

Justice FIELD at page 394 said:

> "Instances of every day occurrence will show the effect of this discrimination in a clear light. A natural person and a railroad company own together a parcel of property in equal proportions subject to a mortgage. In estimating the value of the undivided half belonging to the natural person, half of the amount of the mortgage is deducted. In estimating the value of the undivided half belonging to the railroad company, no part of the mortgage is deducted. The discrimination is made against the company for no other reason than its ownership. * * * Every one sees that the valuation has not in fact changed with the ownership, and therefore that the discrimination is made solely

because a rule is adopted and the assessment of the property of one party different from that applied in the assessment of the property of the other, purely on account of its ownership. A corresponding difference in the tax which the different owners must pay follows the assessment. Thus, if two adjoining tracts are subject to a mortgage, each for half its value, the natural person owning one of them pays a tax on the other half, while the corporation must pay a tax on the whole of its tract; that is, double the tax of the individual. * * *

"The principle which sanctions the elimination of one element in assessing the value of property held by one party, and takes it into consideration in assessing the value of property held by another party, would sanction the assessment of the property of one at less than its value,—at a half or a quarter of it,—and the property of another at more than its value,—at double or treble of it,—according to the will or caprice of the state. To-day railroad companies are under its ban, and the discrimination is against their property. To-morrow it may be that other institutions will incur its displeasure. If the property of railroad companies may be thus sought out and subjected to discriminating taxation, so, at the will of the state, by a change of its constitution, may the property of churches, of universities, of asylums, of savings banks, of insurance companies, of rolling and flouring mill companies, of mining companies, indeed, of any corporate companies existing in the state. The principle which justified such a discrimination in assessment and taxation, where one of the owners is a railroad corporation and the other a natural person, would also sustain it where both owners are natural persons. A mere change in the state constitution would effect this if the federal constitution does not forbid it. Any difference between the owners, whether of age, color, race, or sex, which the state might designate, would be a sufficient reason for the discrimination. It would be a singular comment upon the weakness and character of our republican institutions if the

valuation and consequent taxation of property could vary according as the owner is white, or black, or yellow, or old, or young, or male, or female. A classification of values for taxation upon any such ground would be abhorrent to all notions of equality of right among men. Strangely, indeed, would the law sound in case it read that in the assessment and taxation of property a deduction should be made for the mortgages thereon if the property be owned by white men or by old men, and not deducted if owned by black men or by young men; deducted if owned by landsmen, not deducted if owned by sailors; deducted if owned by married men, not deducted if owned by bachelors; deducted if owned by men doing business alone, not deducted if owned by men doing business in partnerships or other associations; deducted if owned by trading corporations, not deducted if owned by churches or universities; and so on, making a discrimination whenever there was any difference in the character or pursuit or condition of the owner. To levy taxes upon a valuation of property thus made is of the very essence of tyranny, and has never been done except by bad governments in evil times, exercising arbitrary and despotic power."

When the case came before this Court (118 U. S. 394), the Court at page 410 stated that the importance of the constitutional questions could not well be over-estimated, but that they belonged to a class which the Court could not decide unless essential to the disposition of the case. The Court thereupon affirmed on the ground that the entire assessment was a nullity.

The same question was before this Court in *San Bernardino Co.* v. *Southern Pacific R. R. Co.*, 118 U. S. 417. Justice FIELD concurring, stated that he regretted that it had not been deemed consistent with the duty of the Court to decide the important

constitutional questions involved, and at page 422 stated:

> "At the present day nearly all great enterprises are conducted by corporations. Hardly an industry can be named that is not in some way promoted by them and a vast portion of the wealth of the country is in their hands. It is therefore of the greatest interest to them whether their property is subject to the same rules of assessment and taxation as like property of natural persons, or whether elements which affect the valuation of property are to be omitted from consideration when it is owned by them and considered when it is owned by natural persons; and thus the valuation of property be made to vary not according to its condition or use but according to its ownership. The question is not whether the state may not claim for grants or privileges and franchises a fixed sum per year or a percentage of earnings of a corporation—that is not controverted—but whether it may prescribe rules for the valuation of property for taxation which will vary according as it is held by individuals or by corporations. The question is of transcendent importance and it will come here and continue to come until it is authoritatively decided in harmony with the great constitutional amendment which insures to every person whatever his position or association, the equal protection of the laws; and that necessarily implies freedom from the imposition of unequal burdens under the same conditions."

In *County of San Mateo* v. *Southern Pacific R. Co.*, 13 Fed. 145, the case had been removed to the Federal Court, and the opinion was written on a motion to remand. Justice FIELD stated that the rule of equality necessitated by the Fourteenth Amendment had been recognized by Congress as applicable to Federal taxation, at page 150 saying:

> "Equality of protection is thus made the constitutional right of every person; and this

equality of protection implies not only that the same legal remedies shall be afforded to him for the prevention or redress of wrongs and the enforcement of rights, but also that he shall be subjected to no greater burdens or charges than such as are equally imposed upon all others under like circumstances. No one can, therefore, be arbitrarily taxed upon his property at a different rate from that imposed upon similar property of others, similarly situated, and thus made to bear an unequal share of the public burdens. Property may indeed be classified, and different kinds be subjected to different rates. Real property may be taxed at one rate and personal property at another. Property in particular places may be taxed for local purposes, while property situated elsewhere is exempt. License taxes may also vary in amount, according to the calling or business for which they are exacted. But arbitrary distinctions not arising from real differences in the character or situation of the property, or which do not operate alike upon all property of the same kind similarly situated, are forbidden by the amendment. Equality in the imposition of burdens is the constitutional rule as applied to the property of individuals, where it is subject to taxation at all; and this imports that an uniform mode shall be followed in the estimate of its value, and that the contribution exacted shall be in some uniform proportion to such value prescribed, according to the nature or position of the property. All state action, constitutional or legislative, impinging upon the enforcement of this rule, must give way before it. Congress, in its legislation since the adoption of the amendment, has recognized this to be the rule The amendment was adopted in 1868, and in 1870 Congress re-enacted the Civil Rights Act; and to the clause that all persons within the jurisdiction of the United States should enjoy the same rights as white citizens, and be subject only to like punishment, pains, and penalties, it added: and be subject only to

like '*taxes, licenses, and exactions of every kind, and to no other.*' Rev. St. Sec. 1977."

See also *Northern Pac. R. Co.* v. *Walker*, 47 Fed. 681, at 685.

## Conclusion.

The provision complained of prohibits a corporation, one-half of whose indebtedness exceeds its authorized capital stock, from taking its net earnings as a basis of its taxation, and requires it to pay a tax based in part upon its gross receipts. Whatever necessity exists for such a requirement for the purpose of raising revenue, exists equally in the case of all other corporations and of individuals. The discrimination has nothing to do with the production of revenue and cannot be justified on that ground. If a corporation, one-half of whose indebtedness exceeds its capitalization, is to be taxed upon its gross receipts, while a corporation not in such position is taxed upon its net income, the result is a punishment by Congress of the companies whose gross revenues are taxed. Such punishment can only be escaped by increasing their authorized capitalization, in order that the taxation may be confined to their net revenue. The inevitable tendency of this system is to so burden corporations whose authorized capital stock is not adjusted to their indebtedness according to the plan prescribed, that they must conform thereto in order to escape the burden, regardless of the public policy of the State which created them.

According to the same method and principle Congress, might proceed to regulate by taxation any feature of corporate organization or management over which it might choose to assume control. This plaintiff is subjected to a twelve-fold tax, because its capital stock is small as compared with its bonded debt. If that exercise of legislative power is approved we may soon see laws to the effect that cor-

porations having seven directors are to pay a normal tax on their net income only, while corporations having more or less than seven directors are to pay a tax based in part on their gross receipts; or that corporations which do not permit cumulative voting for directors are to be taxed at a greater rate than those that do. We may see tax laws designed to regulate the relative amount of preferred stock issued and the rate of dividends thereon; we may see restrictions on corporate expenses, on officers' salaries and even on the personal habits of officers and members of corporations, all taking the form of discriminating taxes on income. Unless the distinction between legitimate and arbitrary classification is to be drawn at a point so clearly marked as that which appears in the facts of this case, there is no limit to the extent to which Congress may interfere not only with the internal affairs of corporations engaged in business wholly subject to State jurisdiction, but even with the private and personal affairs of the members and directors of such corporations.

## POINT THIRD.

**The statute is invalid in the particular of seeking to tax income received prior to October 3rd, 1913, and the tax complained of is wholly void because based in part upon such income.**

The complaint alleges (Rec., p. 6):

> "The tax assessed against the plaintiff as aforesaid did not purport to be based upon any income received or accrued after the approval of said Act, but purported to be and in fact was

> based upon the amount shown by the return of the plaintiff as its net income for the entire year ending December 31, 1913, of which said net income a large amount actually accrued to and was received by the plaintiff prior to October 3rd, 1913. At the time of the assessment of the said tax there was no competent evidence before the Commissioner of Internal Revenue that any income had accrued to or had been received by the plaintiff on or subsequent to October 3rd, 1913."

The rents and profits received by the plaintiff from its real property prior to October 3rd, 1913, were not on that day "income" in such a sense that they could be taxed by Congress under the authority of the Sixteenth Amendment. Our argument upon this subject is presented in the fourth point of our brief in *Brushaber* vs. *Union Pacific Railroad Company*, No. 140 on this Calendar, to which in order to avoid repetition we beg leave to to refer.

It cannot be contended that any part of the tax assessed against the plaintiff for the year 1913 was authorized by Section 38 of the Act of August 5, 1909, commonly called the "Corporation Tax Law," for the reason that so much of said section as authorized the making of any assessment upon the income of corporations after March 1st, 1913, was expressly repealed by Subdivision S of Section III of said act.

Furthermore, the plaintiff is not engaged in any business other than the receipt and distribution of the rents of its real property. The complaint expressly alleges (Rec., p. 3):

> "The business for which the plaintiff was organized and the only business which the plaintiff has ever conducted is the holding for investment of real property in the State of New York."

The mere receipt of income is not business upon which an excise tax can be levied, otherwise it would have been necessary for this Court to sustain the Income Tax Law of 1894 in its entirety as an excise tax. Accordingly, it was held by this Court in *McCoach* v. *Minehill Ry. Co.*, 228 U. S. 292, and in *Zonne* v. *Minneapolis Syndicate*, 220 U. S., 187, that corporations situated as this plaintiff is, having no other function than the receipt and distribution of rentals, were not subject to taxation under the Act of 1909.

The result of including in the assessment the income of this plaintiff prior to October 3, 1913, is to make the whole tax void. Our argument upon this subject is presented in the fifth point of our brief in *Brushaber* v. *Union Pacific Ry. Co.*, No. 140 on this Calendar, to which in order to avoid repetition we beg to refer.

## POINT FOURTH.

**The judgment should be reversed and the demurrer overruled, with leave to the defendant to answer.**

Dated September 18, 1915.

JULIEN T. DAVIES,
BRAINARD TOLLES,
GARRARD GLENN,
Martin A. Schenck

Of Counsel.

[redacted]

(24,613)

# SUPREME COURT OF THE UNITED STATES.

**OCTOBER TERM, 1914.**

## No. 869.

EDWIN THORNE, PLAINTIFF IN ERROR,

*vs.*

CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE.

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK.

INDEX.



JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., MARCH 23, 1915.

1 THE UNITED STATES OF AMERICA, *ss:*

The President of the United States of America to the Judges of the District Court of the United States for the Southern District of New York, Greeting:

Because in the records and proceedings and also in the rendition of the judgment of a plea which is in the said District Court before you between Edwin Thorne, plaintiff, and Charles W. Anderson, defendant, a manifest error has happened to the great damage of the said Edwin Thorne as by his complaint appears. We being willing that the error, if any has been, should be duly corrected and full and speedy justice done to the parties aforesaid in this behalf, do command you if judgment be therein given that under your seal distinctly and openly you send the record and proceedings aforesaid, with all things concerning the same, to the Supreme Court of the United States together with this writ so that you may have the same at the City of Washington on the 23d day of March 1915 in the said Supreme Court to be then and there held that the record and proceedings aforesaid being inspected the said Supreme Court may cause further to be done to correct that error what of right and according to the laws and customs of the United States should be done.

Witness the Honorable Edward D. White, Chief Justice of the United States, the 24th day of February, in the year of our Lord One thousand nine hundred and fifteen and of the Independence of the United States of America the one hundred thirty-ninth.

ALEX. GILCHRIST, JR.,
*Clerk of the District Court of the United States*
*for the Southern District of New York.*

Allowed by
J. M. MAYER,
*District Judge.*

2 UNITED STATES OF AMERICA,
*Southern District of New York, ss:*

I, Alexander Gilchrist, Jr., Clerk of the District Court of the United States of America, for the Southern District of New York, in the Second Circuit, by virtue of the foregoing Writ of Error, and in obedience thereto, do hereby certify, that the following pages numbered from four to 25 inclusive, contain a true and complete transcript of the record and proceedings had in said Court in the cause of Edwin Thorne Plaintiff in Error, against Charles W. Anderson, Defendant in Error, as the same remain of record and on file in said office.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern Districtof New York, in the Second Circuit, this 11th day of March, in the year of our Lord one thousand nine hundred and fifteen, and of

the Independence of the United States the one hundred and thirty-ninth.

[Seal District Court of the United States, Southern District of New York.]

ALEX. GILCHRIST, JR., *Clerk.*

3 [Endorsed:] L. 13-250. District Court of the U. S., Southern District of N. Y. Edwin Thorne, Plaintiff, against Charles W. Anderson, Defendant. (Original.) Writ of Error. 1.10. K. Davies, Auerbach & Cornell, Attorneys for Plaintiff, Mutual Life Building, 34 Nassau Street, New York City. U. S. District Court, S. D. of N. Y. Filed Feb. 24, 1915.

4 United States District Court for the Southern District of New York.

EDWIN THORNE
against
CHARLES W. ANDERSON.

To the above-named Defendant:

You are hereby summoned to answer the complaint in this action, and to serve a copy of your answer on the plaintiff's attorney within twenty days after the service of this summons, exclusive of the day of service; and in case of your failure to appear, or answer, judgment will be taken against you by default for the relief demanded in the complaint.

Witness, the Hon. Charles M. Hough, Judge of the District Court of the United States for the Southern District of New York, at the City of New York, this 24th day of December in the year one thousand nine hundred and fourteen.

ALEX. GILCHRIST, JR., *Clerk.*

Davies, Auerbach & Cornell, Plaintiff's Attorney, Office and Post Office Address, 34 Nassau St., Borough of Manhattan, New York City.

5 Office Copy.

*Affidavit of Service of Summons and Complaint.*

United States District Court for the Eastern District of New York.

EDWIN THORNE, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

STATE AND COUNTY OF NEW YORK, *ss:*

Jesse C. Millard being duly sworn, says, that he is over twenty one years of age, And that on the 14th day of November 1914 at the

United States Customs House Borough of Manhattan, City, County & State of New York he served the summons hereto annexed, and the complaint in this action upon Charles W. Anderson defendant in this action, by delivering a true copy of said summons and complaint to such defendant personally, and leaving the same with him. He further says, that he knew the person served as aforesaid to be the person mentioned and described in the said summons as the defendant in this action.

JESSE C. MILLARD.

Sworn to before me, this 16th day of November 1914.
[NOTARIAL SEAL.] FRANK G. TITUS,
*Notary Public, New York County, No.* 3846.

New York County Register's No. 6003.
Commission Expires March 30, 1916.

6 In the District Court of the United States for the Southern District of New York.

EDWIN THORNE, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

*Complaint.*

The plaintiff, by Davies, Auerbach & Cornell, his attorneys, for his complaint against the defendant, respectfully shows:

First. The plaintiff is a citizen of the State of New York, residing at West Islip, in the County of Suffolk, in the Eastern District of New York, and having an office as director and officer of certain corporations at No. 19 Cedar Street, in the County of New York, in the Second Collection District of said State.

Second. The defendant is the Collector of Internal Revenue for the Second Collection District of the State of New York.

Third. On or about the 21st day of May, 1914, under the alleged authority of subsection E of Section II of the Act of Congress approved October 3, 1913, entitled "An Act to reduce tariff duties and provide revenue for the government and for other purposes", there was assessed upon the plaintiff by the Commissioner of Internal Revenue a tax of Three hundred fifty-two and 1/100 dollars ($352.01), and thereafter notice of said assessment was duly
7 given to the plaintiff and a demand was made upon the plaintiff by the defendant for payment of said tax on or before the 30th day of June, 1914, at the United States Custom House Building in the City of New York, in order to avoid penalty and interest. Of said tax only $7 was the normal tax mentioned in said Act, and the remainder was a super-tax levied upon the plaintiff over and above the normal rate of taxation, upon the ground that plaintiff's income from all sources for the period covered by said assessment exceeded

the rate of $20,000 a year. Thereafter, and on or about the 3rd day of June, 1914, the plaintiff paid to the defendant, under protest and under duress, the said sum of Three hundred fifty-two and 1/100 dollars ($352.01).

Fourth. Thereafter, and on or about the 7th day of June, 1914, the plaintiff duly appealed to the Commissioner of Internal Revenue against the assessment and collection of said tax, and demanded the repayment of the amount so collected, upon the ground that the said tax was erroneously and illegally assessed and collected, for the reasons specified in said petition of appeal, and thereupon the said Commissioner sustained said appeal to the extent of $7, which sum he directed to be refunded to this plaintiff, and overruled and denied said appeal in all other respects.

Fifth. The tax collected by the defendant from the plaintiff as above described was erroneously and illegally assessed and collected, particularly in the following respects:

(1) Section II of said Act of Congress approved October 3, 1913, is unconstitutional and void because it is not a due exercise of
8 the taxing power conferred by the Constitution upon Congress, because it involves the taking of property without due process of law and the taking of property for public use without compensation, and because the classifications, discriminations and inequalities contained in said Act are arbitrary and have no reasonable relation to the production of revenue for the purposes of the Government, but are intended solely to regulate the conduct and affairs of the citizens and residents of the United States in respect to matters which are not within the powers delegated to Congress by the Constitution.

(2) Section II of the said Act approved October 3, 1913, in so far as it purports to tax this appellant and other persons having taxable incomes exceeding $20,000 at a different rate from persons having taxable incomes of less than $20,000, involves an arbitrary and unreasonable classification of the persons subject to the tax, based solely upon wealth, and having no reasonable relation to any power conferred upon Congress by the Constitution.

(3) Section II of the said Act approved October 3, 1913, is not based upon any census or enumeration made as required by the Constitution, and is dependent for its validity upon the express authority given by the Sixteenth Amendment to the Constitution of the United States in relation to the taxation of income as such. The tax assessed against the plaintiff as aforesaid did not purport to be based upon any income received or accrued after the approval of said Act, but purported to be, and in fact was, based upon the amount shown by the return of this plaintiff as his net income for the period of
9 ten months beginning March 1, 1913, a large amount of which said net income actually accrued to and was received by this plaintiff prior to October 3d, 1913. At the time of the assessment of said tax there was no competent evidence before the Commissioner of Internal Revenue that any income had accrued to or had been received by this plaintiff on or subsequent to October 3, 1913.

Wherefore, the plaintiff demands judgment against the defendant in the sum of Three hundred forty-five and 1/100 dollars ($345.01), with interest from the 3rd day of June, 1914, and the costs of this action.

DAVIES, AUERBACH & CORNELL,
*Attorneys for Plaintiff.*

Office and Post-Office Address: 34 Nassau Street, Borough of Manhattan, New York City.

STATE OF NEW YORK,
*City and County of New York, ss:*

Edwin Thorne, being duly sworn, deposes and says that he is the plaintiff above-named; that he has read the foregoing complaint and knows the contents thereof, and that the same is true of his own knowledge, except as to the matters therein stated to be alleged on information and belief, and as to those matters he believes it to be true.

EDWIN THORNE.

Sworn to before me, this 24 day of December, 1914.

[N. S.] SAMUEL THORNE, JR.,
*Notary Public, Westchester County.*

Certificate filed in New York County.
Term expires March 31, 1916.

(Endorsed:) U. S. District Court, S. D. of N. Y. Filed Dec. 29, 1914.

10 United States District Court, Southern District of New York.

EDWIN THORNE, Plaintiff,
vs.
CHARLES W. ANDERSON, Defendant.

*Demurrer to Complaint.*

The defendant demurs to the complaint herein on the ground that, as appears upon the face thereof, it does not state facts sufficient to constitute a cause of action.

Dated New York, February 2, 1915.

H. SNOWDEN MARSHALL,
*United States Attorney for the Southern District of New York, Attorney for Defendant.*

Office and Post Office Address: U. S. Court House Bldg., Borough of Manhattan, City of New York.

11 CITY OF NEW YORK,
*County of New York, State of New York, ss:*

Ben A. Matthews, being duly sworn, deposes and says, that he is an Assistant United States Attorney for the Southern District of New York, and as such has charge of the above-entitled case; that the above demurrer is not interposed for the purpose of delay, and that he verily believes that the complaint herein is bad in law.

BEN A. MATTHEWS.

Sworn to before me this 2nd day of February, 1915.
[SEAL.] FREDERICK D. CAMPBELL,
*Notary Public, Kings County, No.* 187.

Certificate filed in New York County, No. 61, New York County.
Register's No. 5164, New York County.
Register's No. 6176, Kings County.
My Commission Expires March 30, 1915.

(Endorsed:) U. S. District Court, S. D. of N. Y. Filed Feb. 5, 1915.

12 *Notice of Motion for Judgment..*

United States District Court, Southern District of New York.

L—13—250.

EDWIN THORNE, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

SIR: Pease take notice that on the complaint in the above entitled action and the demurrer interposed thereto, the undersigned will move this court at a stated term thereof, for the hearing of motions on the 11th day of February, 1915, at 10:30 o'clock in the forenoon of said day at the Postoffice Building, Borough of Manhattan, City of New York, or as soon thereafter as counsel can be heard for judgment upon the pleadings herein and for such other and further relief as to the court may seem just and proper.

Yours, etc.,
DAVIES, AUERBACH & CORNELL,
*Attorneys for the Plaintiff, 34 Nassau Street, New York City.*

To H. Snowden Marshall, Esq., United States Dist. Attorney and Attorney for the Defendant, Post Office Building, Borough of Manhattan, New York City.

(Endorsed:) Copy Received Feb. 6/15. H. Snowden Marshall, U. S. Att'y.—U. S. District Court, S. D. of N. Y. Filed Feb. 15, 1915.

13 At a Stated Term of the District Court of the United States for the Southern District of New York, Held at the United States Court Rooms, in the Borough of Manhattan, City of New York, on the 11th Day of February, 1915.

Present: Hon. Julius M. Mayer, Judge.

L—13/250.

EDWIN THORNE, Plaintiff,
vs.
CHARLES W. ANDERSON, Defendant.

*Order Sustaining Demurrer.*

This cause having come on before me upon demurrer filed by the defendant to the complaint herein, and after hearing Ben A. Matthews, Assistant United States Attorney, in support of said demurrer, and Brainard Tolles, in opposition thereto, and after due deliberation;

Now, upon motion of H. Snowden Marshall, United States Attorney, to sustain the demurrer and dismiss the complaint herein upon the ground that Section 2 of the Act of Congress, approved October 3, 1913, is in all respects constitutional and valid, it is

Ordered, that the said demurrer be and the same hereby is in all respects sustained; and it is

Further ordered, that the complaint herein be and the same hereby is dismissed; and it is

Further ordered, that judgment on the merits be entered for defendant with costs.

J. M. MAYER, *U. S. D. J.*

Notice of Settlement waived—
Consented to as to form.
DAVIES, AUERBACH & CORNELL,
*Attorneys for Plaintiff.*

(Endorsed:) U. S. District Court, S. D. of N. Y. Filed Feb. 15, 1915.

14 *Judgment.*

United States District Court, Southern District of New York.

L. 13/250.

EDWIN THORNE, Plaintiff,
vs.
CHARLES W. ANDERSON, Defendant.

This cause having come on for hearing before the Honorable Julius M. Mayer, District Judge upon the demurrer filed by the de-

fendant to the complaint herein, at a stated term held on the 11th day of February, 1915, and Ben A. Matthews, Esq., Assistant United States Attorney, appearing in support of said demurrer, and Brainard Tolles, Esq., in opposition thereto; and due deliberation having been had thereon and an order having been entered on the 15th day of February, 1915, wherein it was ordered that the complaint be dismissed with costs, and the costs having been taxed at the sum of Sixteen & 90/100 Dollars;

Now on Motion of H. Snowden Marshall, Esq., United States Attorney for the Southern District of New York, attorney for defendant, it is adjudged that the defendant, Charles W. Anderson, herein, have judgment against the plaintiff, Edwin Thorne, on the merits and that the defendant recover from the plaintiff the sum of Sixteen — 90/100 Dollars; and that the defendant have execution therefor.

Judgment signed this 18th day of February, 1915.

ALEX. GILCHRIST, JR.
*Clerk U. S. District Court.*

(Endorsed:) U. S. District Court, S. D. of N. Y. Filed Feb. 18, 1915, 4.00 P. M.

15 In the District Court of the United States for the Southern District of New York.

EDWIN THORNE, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

*Petition for Writ of Error.*

To the Honorable Judges of the District Court of the United States for the Southern District of New York:

The petition of Edwin Thorne, the plaintiff herein, respectfully shows that on or about the 18th day of February, A. D. 1915, judgment was duly entered in this court in this cause in favor of the defendant and against the plaintiff dismissing the complaint, in which judgment and the proceedings had prior thereto in this cause certain errors were committed to the prejudice of this plaintiff, all of which will more in detail appear from the assignment of errors which is filed with this petition.

Wherefore, this plaintiff prays that a writ of error may issue in this behalf out of the Supreme Court of the United States for the correction of the errors so complained of and that a transcript of the record, proceedings and papers in this cause duly authenticated may be sent to the Supreme Court of the United States.

DAVIES, AUERBACH & CORNELL,
*Attorneys for Plaintiff.*

(Endorsed:) U. S. District Court, S. D. of N. Y. Filed Feb. 24, 1915.

16 In the District Court of the United States for the Southern District of New York.

EDWIN THORNE, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

*Order Allowing Writ of Error.*

This 24th day of February, A. D., 1915 comes the plaintiff, by his attorney, and files herein and presents to the court his petition praying for the allowance of a writ of error and an assignment of errors intended to be urged by him, praying also that a transcript of the record, proceedings and papers upon which the judgment herein was rendered, duly authenticated, may be sent to the Supreme Court of the United States and that such other and further proceedings may be had as are proper in the premises.

On consideration whereof the court does allow the writ of error upon the plaintiff's giving bond according to law in the sum of $250, which shall operate as a supersedeas bond.

N. Y. Feb'y 24, 1915.

J. M. MAYER, *U. S. D. J.*

(Endorsed:) U. S. District Court, S. D. of N. Y. Filed Feb. 24, 1915.

17 In the District Court of the United States for the Southern District of New York.

EDWIN THORNE, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

*Assignment of Errors.*

Now comes the plaintiff, Edwin Thorne, and assigns errors in the trial and decision of this cause, as follows:

First. The court erred in sustaining the demurrer of the defendant to the complaint herein.

Second. The court erred in holding that the complaint herein did not state facts sufficient to constitute a cause of action.

Third. The court erred in holding that Section 2 of the Act of Congress approved October 3rd, 1913, entitled "An Act to reduce tariff duties and provide revenue for the government and for other purposes" is in all respects constitutional and valid.

Fourth. The court erred in holding that Section 2 of said Act of Congress approved October 3rd, 1913 is an exercise of the power con-

ferred upon Congress by the Sixteenth Amendment to the Constitution to tax incomes from whatever source derived.

Fifth. The court erred in holding that section 2 of the said Act approved October 3rd, 1913, in so far as it purports to tax this plaintiff and other persons having taxable incomes exceeding $20,000
18 at a different rate from persons having taxable incomes less than $20,000 is constitutional and valid.

Sixth. The court erred in holding that Section 2 of said Act approved October 3rd, 1913 in so far as it purports to tax the income of the plaintiff received and expended or merged in the general assets of the plaintiff prior to the passage of said Act, is constitutional and valid.

Seventh. The court erred in dismissing the complaint and in directing judgment in favor of the defendant upon the merits with costs.

Wherefore, plaintiff prays that the judgment of the said District Court may be reversed.

DAVIES, AUERBACH & CORNELL,
*Attorneys for Plaintiff.*

(Endorsed:) U. S. District Court, S. D. of N. Y. Filed Feb. 24, 1915.

19 Know all men by these presents, that we, Edwin Thorne, as principal, and National Surety Company, as surety, are held and firmly bound unto Charles W. Anderson in the full and just sum of Two Hundred Fifty Dollars ($250) to be paid to the said Charles W. Anderson, his attorneys, executors, administrators or assigns; for which payment well and truly to be made we bind ourselves, our heirs, executors, administrators and legal representatives jointly and severally by these presents.

Sealed with our seals this 23rd day of February in the year of our Lord One thousand nine hundred and fifteen.

Whereas, lately in the District Court of the United States for the Southern District of New York, in a suit depending in said court between Edwin Thorne, plaintiff, and Charles W. Anderson, defendant, a judgment was rendered against the said Edwin Thorne and said Edwin Thorne having obtained a writ of error and filed a copy thereof in the Clerk's office of the said court to review the judgment in the aforesaid suit, and a citation having issued directed to the said Charles W. Anderson citing and admonishing him to be and appear at a session of the Supreme Court of the United States to be holden at the City of Washington on the — day of —— next.

Now, the condition of the above obligation is such that if the said Edwin Thorne shall prosecute said writ of error to effect and answer all damages and costs, if he fail to make his plea good, then

the above obligation to be void, else to remain in full force and effect.

NATIONAL SURETY COMPANY,
By WM. A. THOMPSON,
*Resident Vice President.*

Approved by:

____ ____,
*U. S. District Judge.*

Sealed and delivered in the presence of:

____ ____.

[CORPORATE SEAL.]

Attest:
N. V. TYNAN,
*Resident Ass't Secretary.*

20 EDWIN THORNE, *Principal.*

STATE OF NEW YORK,
*County of New York,*
*Southern District of New York, ss:*

On this 25th day of February, in the year One Thousand nine hundred and fifteen, before me, the undersigned, personally came Edwin Thorne, to me personally known, and known to me to be the individual described in and who executed the foregoing instrument, and he acknowledged before me that he executed the same for the purposes therein mentioned.

[NOTARIAL SEAL.] HENRY C. FIELD,
*Notary Public, Kings County, No.* 162.

Kings County Register No. 7649.
Cert. Filed in New York County, No. 81.
New York Register No. 5207.

Approved by:
J. M. MAYER,
*U. S. District Judge.*

21 Capital $2,000,000.00.

*Affidavit, Acknowledgment, and Justification by Guarantee or Surety Company.*

STATE OF NEW YORK,
*County of New York ss:*

On this 23rd day of February one thousand nine hundred and fifteen before me personally came Wm. A. Thompson, known to me

to be the Resident Vice-President of the National Surety Company, the corporation described in and which executed the within and foregoing Bond of Edwin Thorne, as a surety thereon, and who, being by me duly sworn, did depose and say that he resides in the City of New York, State of New York; that he is the Resident Vice-President of said Company, and knows the corporate seal thereof; that the said National Surety Company, is duly and legally incorporated under the laws of the State of New York; that said Company has complied with the provisions of the Act of Congress of August 13th, 1894; that the seal affixed to the within Bond of Edwin Thorne, is the corporate seal of said National Surety Company, and was thereto affixed by order and authority of the Board of Directors of said Company; that he signed his name thereto by like order and authority as Resident Vice-President of said Company; that he is acquainted with N. V. Tynan and knows him to be the Resident Assistant Secretary of said Company; that the signature of said N. V. Tynan subscribed to said Bond is in the genuine handwriting of said N. V. Tynan, and was thereto subscribed by order and authority of said Board of Directors, and in the presence of said deponent; that the assets of said Company, unencumbered and liable to execution exceed its debts and liabilities of every nature whatsoever, by
22 more than the sum of Two Million ($2,000,000) dollars.

That — is agent to acknowledge service for said Company in the Judicial District wherein this bond is given.

[CORPORATE SEAL.] WM. A. THOMPSON,
*(Deponent's Signature.)*

Sworn to, acknowledged before me, and subscribed in my presence this 23rd day of February, 1915.

[NOTARIAL SEAL.] H. E. EMMETT,
*(Officer's Signature, Description and Seal.)*
*Notary Public for Kings County, No. 3.*

Certificate filed in New York County, No. 2, Nassau, Bronx, Queens, Richmond and Westchester Counties.
Kings County Register's Office No. 6802.
New York County Register's Office No. 6617.
Bronx County Register's Office No. 608.

(Endorsed:) U. S. District Court, S. D. of N. Y., Filed Feb. 26, 1915.

23 UNITED STATES OF AMERICA, *ss:*

To Charles W. Anderson, Greeting:

You are hereby cited and admonished to be and appear at the Supreme Court of the United Statees to be holden at the City of Washington on the 23d day of March next, pursuant to a writ of error filed in the Clerk's office of the District Court of the United

States for the Southern District of New York, wherein Edwin Thorne is plaintiff and you are defendant in error, to show cause, if any there by, why the judgment rendered against the said plaintiff in error as in said writ of error mentioned should not be corrected and speedy justice be done to the parties in that behalf.

Given under my hand at the City of New York in the district above named this 24th day of February, in the year of our Lord One thousand nine hundred and fifteen.

J. M. MAYER,
*Judge of the District Court of the United States for the Southern District of New York.*

A. E. JR.

24 [Endorsed:] L. 13—250. District Court of the U. S. Southern District of N. Y. Edwin Thorne, Plaintiff, against Charles W. Anderson, Defendant. (Original.) Citation. 10. K. Davies, Auerbach & Cornell, attorneys for plaintiff. Mutual Life Building, 34 Nassau Street, New York City. U. S. District Court S. D. of N. Y. Filed Feb. 24, 1915.

Service of a copy of the within citation is hereby admitted this 24th day of February, 1915. The copy of the within paper has been this day received at this office. Feb. 23, 1915. H. Snowden Marshall, U. S. Attorney. United States District Attorney and Attorney for the Defendant in Errors.

25 United States District Court, Southern District of New York.

L. 13—250.

EDWIN THORNE, Plaintiff,
vs.
CHARLES W. ANDERSON, Defendant.

It is hereby stipulated and agreed that the Record on Appeal in the above entitled action to the Supreme Court of the United States shall consist of the followings papers, to wit:

Summons,
Affidavit of Service of Summons,
Complaint,
Demurrer to Complaint,
Notice of Motion for Judgment,
Order sustaining Demurrer,
Judgment,
Petition for Writ of Error,
Assignment of Errors,
Bond on Appeal,
Order allowing Writ of Error,
Writ of Error,
Citation,

and may be so certified by the Clerk of the United States District Court for this District.

Dated March 2, 1915.

DAVIES, AUERBACH & CORNELL,
*Attorney- for Plaintiff.*

H. SNOWDEN MARSHALL,
*U. S. Attorney, Attorney for Defendant.*

[Endorsed:] United States Supreme Court. Edwin Thorne, Plaintiff in Error, vs. Charles W. Anderson, Defendant in Error. Transcript of Record. Error to the District Court of the United States for the Southern District of New York.

Endorsed on cover: File No. 24,613. S. New York D. C. U. S. Term No. 869. Edwin Thorne, plaintiff in error, vs. Charles W. Anderson, Collector of Internal Revenue. Filed March 12th, 1915. File No. 24,613.

# Supreme Court of the United States.

OCTOBER TERM, 1915.
No. 394.

EDWIN THORNE,
*Plaintiff-in-Error,*

*against*

CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE,
*Defendant-in-Error.*

## BRIEF FOR PLAINTIFF-IN-ERROR.

JULIEN T. DAVIES,
BRAINARD TOLLES,
GARRARD GLENN,
Martin A. Schenck
*Counsel for Plaintiff-in-Error.*

The Evening Post Job Printing Office, Inc., 156 Fulton St., N. Y.

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# Supreme Court of the United States,

OCTOBER TERM, 1915.

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|---|---|
| EDWIN THORNE, Plaintiff in Error, AGAINST CHARLES W. ANDERSON, Collector of Internal Revenue, Defendant in Error. | No. 394. |

## BRIEF FOR DEFENDANT IN ERROR.

In this case the Court has before it a writ of error to the District Court of the United States for the Southern District of New York. The plaintiff sued for $352.01, the amount of an income tax for the year 1913 collected from him by the defendant under duress and under protest. The defendant demurred and the District Court gave judgment in favor of the defendant and against the plaintiff dismissing the complaint (Rec., p. 8, fol. 15). The plaintiff then duly sued out a writ of error to this court, and assigned errors (Rec., p. 9, fols. 16-18).

## Statement of Facts.

The complaint alleges as follows:—The plaintiff is a citizen of New York. On May 21, 1914, the Commissioner of Internal Revenue, acting under the Income Tax Law, assessed a tax upon the plaintiff of $352.01. Thereafter notice of the assessment was given to the plaintiff, and a demand was made upon him by the defendant for payment of the tax on or before June 30, 1914, in order to avoid penalty and interest. Of this tax the normal tax amounted to $7.00, the remainder being a super tax levied above the normal rate of taxation, upon the ground that the plaintiff's income exceeded $20,000 per annum. On June 3, 1914, under protest and duress, the plaintiff paid the assessed tax to the defendant. On June 7, 1914, the plaintiff appealed to the Commissioner of Internal Revenue, and his appeal was denied (Rec., pp. 3-4).

The complaint then alleges that the Income Tax Law is unconstitutional for the following reasons:

(*a*) It takes property without due process of law, and for public use without compensation. The classification and discriminations contained in the act are arbitrary. They have no reasonable relation to the production of revenue for governmental purposes, but are intended solely to regulate the conduct and affairs of citizens respecting matters which are not within the powers constitutionally delegated to Congress.

(*b*) So far as the statute purports to tax the plaintiff's income in excess of $20,000 at a different rate from incomes of less than $20,000, the statute makes an arbitrary classification of persons subject to the tax, based solely upon wealth and having no

reasonable relation to any power constitutionally conferred upon Congress.

(c) The statute's validity depends only upon the Sixteenth Amendment. The tax did not purport to be based upon income received or accrued after the passage of the act, but purported to be based upon the amount shown by the plaintiff's return as his net income for the period of ten months commencing March 1, 1913. *A large amount of this income actually accrued to and was received by the plaintiff prior to that date, and at the time of the assessment of the tax there was no competent evidence before the Commissioner that any income had been received by the plaintiff subsequent to October 3, 1913.*

The complaint demands judgment for the return of the tax money paid, with interest and costs.

## Assignment of Errors.

The plaintiff specifies the following errors as those relied upon:

1. Section 2 of the Act of Congress of October 3, 1913, is not a valid exercise of the power conferred upon Congress by the Sixteenth Amendment to tax incomes, from whatever source derived, and the Court erred in so deciding.

2. The law taxes the plaintiff and other persons having taxable income exceeding $20,000 upon such excess at a different rate from persons having taxable income less than $20,000, and the Court erred in deciding that this provision was constitutional and valid.

3. The law taxes the income of the plaintiff received prior to October 3d, 1913, and expended or merged in his general assets prior to the passage of the act, and the Court erred in holding this was constitutional and valid.

## OUTLINE OF ARGUMENT.

The argument, with respect to the taxation of that portion of income which accrued prior to the statute's adoption, is discussed in the briefs submitted in a contemporaneous case, and will not be repeated here.

Outside of that, this case deals principally with the "super-tax" imposed upon incomes exceeding $20,000.

This super-tax is imposed by virtue of the following provision of the Income Tax Act (Act of October 3, 1913, Sec. II, Subd. 2):

> "In addition to the income tax provided under this section (herein referred to as the 'normal income tax'), there shall be levied, assessed and collected upon the net income of every individual an additional income (herein referred to as the 'additional tax') of one per centum per annum upon the amount by which the total net income exceeds $20,000 and does not exceed $50,000, and two per centum per annum upon the amount by which the total income exceeds $50,000 and does not exceed $75,000, three per centum per annum upon the amount by which the total net income exceeds $75,000 and does not exceed $100,000, four per centum per annum upon the amount by which the total net income exceeds $100,000 and does not exceed $250,000, five per centum per annum upon the amount by which the total

> net income exceeds $250,000 and does not exceed $500,000, and six per centum per annum upon the amount by which the total net income exceeds $500,000".

By this language the statute undertakes to impose upon this country a system of so-called progressive taxation. In no case previously before this Court has its attention been commanded to the constitutional aspects of this system. Lately an attempt was made to present to this Court questions arising from what the Chief Justice styled "a new system of state taxation described as 'progressive income taxation' "; but the writ of error was dismissed on the ground that the relator had no authority to sue (*Bolens* v. *Wisconsin*, 231 U. S. 616, 617).

Questions arising under such a system of progressive income taxation are now presented to the Court.

The main question is one of construction of the Sixteenth Amendment, which in full is as follows:

> "The Congress shall have power to lay and collect taxes on incomes from whatever source derived, without apportionment among the several States and without regard to any census or enumeration."

Does the power thus conferred upon Congress, to levy and collect taxes upon incomes from whatever source derived, include the power to levy progressive income taxes?

## POINT I.

**The effect of the Sixteenth Amendment was merely to waive the requirement of apportionment among the States in its application to a general and uniform tax upon incomes from whatever source derived. The income tax law of 1913, except in so far as the tax thereby imposed is in reality such a general and uniform tax on incomes, derives no support from the Sixteenth Amendment.**

Our views in regard to the scope and meaning of the Sixteenth Amendment in the light of its history are presented in a subsequent point of this brief and also in the First Point of our brief in *Brushaber* v. *Union Pacific Railroad Company*, No. 140 on this calendar, to which, in order to avoid repetition, we beg leave to refer.

## POINT II.

**In its progressive feature, the statute classifies persons according to their wealth, in a manner which is both arbitrary and unreasonable.**

In addition to the normal 1 per cent. tax upon the whole income there is also imposed by the

statute an annual graduated tax upon increased amounts of net income of every individual over $20,000. This tax scales as follows:

On the excess of income over $20,000 and under $50,000. . . . . 1%
On the excess of income over $50,000 and under $75,000. . . . . 2%
On the excess of income over $75,000 and under $100,000. . . . . 3%
On the excess of income over $100,000 and under $250,000. . . . . 4%
On the excess of income over $250,000 and under $500,000. . . . . 5%
On the excess of income over $500,000. . . . . 6%

In short, if one has an income of $20,000 he pays only an annual normal tax of 1 per cent. If, however, his income is $25,000, not only does he continue to pay the normal 1 per cent. tax on the whole amount of $25,000 but he also pays an additional 1 per cent. on $5,000. If his income exceeds $50,000, he pays not only the normal 1 per cent. on the entire $50,000 and an additional 1 per cent. on $30,000 but also he pays 2 per cent. on the figure by which his income exceeds $50,000, up to $75,000, and so on upwards. The result is that a man whose income is less than $20,000 pays one tax, a man whose income exceeds $20,000 pays one, two, three or more taxes in addition, according to the amount by which his income exceeds $20,000.

On September 30, 1913, Mr. Underwood, speaking in the House of Representatives, in support of the bill which afterwards became the law under review, gave the following estimate of income and

revenue from the operation of the act during its first year (Cong. Rec., Sept. 20, 1913, p. 5775):

*Estimated Incomes and Revenues therefrom for the first year under H. R. 3221.*

| Incomes (Am't.) | No. of Incomes. | Tax Rate. | Revenue. |
|---|---|---|---|
| $3,000 to $4,000 | 75,000 | 1% | $375,000 |
| 4,000 to 5,000 | 126,000 | 1% | 630,000 |
| 5,000 to 10,000 | 178,000 | 1% | 5,340,000 |
| 10,000 to 15,000 | 53,000 | 1% | 4,240,000 |
| 15,000 to 20,000 | 24,500 | 1% | 3,185,000 |
| 20,000 to 25,000 | 10,500 | 1 and 2% | 2,100,000 |
| 25,000 to 50,000 | 21,000 | 1 and 2% | 9,660,000 |
| 50,000 to 75,000 | 6,100 | 1, 2 and 3% | 6,832,000 |
| 75,000 to 100,000 | 2,400 | 1, 2, 3 & 4% | 4,776,000 |
| 100,000 to 250,000 | 2,500 | 1, 2, 3, 4 & 5% | 13,775,000 |
| 250,000 to 500,000 | 550 | 1, 2, 3, 4, 5 & 6% | 8,805,500 |
| 500,000 to 1,000,000 | 350 | 1, 2, 3, 4, 5, 6 & 7% | 13,653,500 |
| 1,000,000 and over | 100 | 1, 2, 3, 4, 5, 6 & 7% | 9,301,000 |
| | 500,000 | | $82,673,000 |

According to this estimate approximately 83 1-3 per cent. of the gross revenue which this act was expected to produce was to be paid by persons subject to the additional tax assessed at the progressive rates. The actual results of the income taxation of individuals differ somewhat from this estimate of the numbers of those liable, and quite largely from the estimate of the productiveness of this tax (Report of Comptroller of Int. Rev. for 1914, p. 20). The following table shows the number of returns made by individuals and the income tax paid by them for the ten months of 1913, from March 1 to January 1, 1914:

| Net Income. | Number of Returns. | | Surtax Paid. |
|---|---|---|---|
| $2,500 to $3,333 | 79,426 | | |
| 3,333 to 5,000 | 114,484 | | |
| 5,000 to 10,000 | 101,718 | | |
| 10,000 to 15,000 | 26,818 | | |
| 15,000 to 20,000 | 11,977 | | |
| 20,000 to 25,000 | 6,817 | | |
| 25,000 to 30,000 | 4,164 | | $2,934,754 |
| 30,000 to 40,000 | 4,553 | | |
| 40,000 to 50,000 | 2,427 | | |
| 50,000 to 75,000 | 2,618 | | 1,645,639 |
| 75,000 to 100,000 | 998 | | 1,323,023 |
| 100,000 to 150,000 | 785 | | |
| 150,000 to 200,000 | 311 | | 3,835,948 |
| 200,000 to 250,000 | 145 | | |
| 250,000 to 300,000 | 94 | | |
| 300,000 to 400,000 | 84 | | 2,334,583 |
| 400,000 to 500,000 | 44 | | |
| 500,000 to 1,000,000 | 91 | | 3,437,850 |
| 1,000,000 and over | 44 | (Compromises) | 13,698 |
| | 357,598 | | $15,525,495 |
| Normal tax of 1% on all incomes..... | | | 12,728,038 |
| Total income tax for 1913..... | | | $28,253,533 |

Of this total tax New York, Pennsylvania and Massachusetts paid $17,204,728, being 60 per cent.

Those possessed of incomes over $20,000 paid in surtax 55 per cent. of the entire tax besides paying their normal tax of 1 per cent. (Annual Report, 1914, of Commr. of Internal Revenue, pp. 6, 20.)

The results of the collection of the income tax of individuals for 1914 were as follows:

Income tax, normal.....$16,577,089
Income tax, surtax ..... 24,469,076

Those possessed of incomes over $20,000 paid in surtax over sixty-seven (.67) per cent. of the entire tax, besides paying their normal tax of 1 per cent. (Report Commr. of Internal Revenue, dated August 2, 1915.)

A calculation based upon the amounts of the separate incomes of individuals would doubtless

show that the original estimate, that the payees of the surtax would constitute over sixty per cent. of the entire income tax, was justified by the results of the operation of the statute.

It cannot be denied that the progressive feature of this statute was considered by the framers, and has turned out to be, of primary importance as the principal factor in the production of revenue. In short, a statute which professes to be a general revenue act to take the place of the tariff duties which formerly had met the expenses of the Government, was intended and operates to levy a tax, as to three-fourths of its extent, upon the persons in this country who have an income exceeding $20,000 per annum. Nor can it be denied that this involves a general classification of persons based upon the amount of their wealth. The act contains an exemption of $4,000 to a married man living with his wife and of $3,000 to a single man. These amounts are the interest at 4 per cent. upon $100,000 and $75,000 of capital respectively. Generally speaking, the posession of $100,000 and $75,000 in most parts of the United States would classify the possessor as wealthy, while the possession of an income of $20,000, which is 4 per cent. on $500,000, would classify the possessor as very wealthy. To sustain this feature of the act involves the recognition of the principle that the burden of the Government must be borne not by the general body of the citizens but by the very wealthy without any contribution by those who are in any other class, even in the class of the wealthy.

If the bold statement were made that a man should pay a tax of 6 per cent. per annum upon his income because his wealth or fortune exceeds $10,000,000, we should have no difficulty in realiz-

ing that the tax imposed was based solely upon the amount of his wealth. If we found that a tax of 5 per cent. per annum was imposed upon a person whose fortune was greater than $5,000,000 but less than $10,000,000, and so on, down to fortunes of more than $400,000, we should at once come to the conclusion that these persons were taxed at certain rates solely because of the amount of their fortunes.

Progressive taxation makes exactly that discrimination; that is frankly admitted by its apologists.

*Seligman* "Progressive Taxation," 2nd ed., page 129, summarizes the theory of the German economist Adolf Wagner. In speaking of his second period in the history of public finance, Prof. Seligman says:

> "The essence of the second period consists in the predominance of social reasons over purely fiscal reasons.
>
> "The State is no longer satisfied merely with raising an adequate revenue but now considers it a duty to interfere with the rights of private property in order to bring about a more equitable distribution of wealth."

Thomas Paine stated that the chief object of progressive taxation was not so much to produce revenue as to extirpate the overgrown influence arising from the unnatural law of primogeniture. ("Rights of Man", London ed. of 1817, Pt. 2, pp. 99, 101.)

*De Retz de Serviez,* in his book "De l'Impot Progressif" (1904), pages 31, 32, quotes the Jacobins of 1793 in adopting the theory of pro-

gression (see Point III, *infra*) as declaring (freely translated):

> "That there was no better way of uprooting large fortunes. Those that they could not tear down at a single blow they would wear down bit by bit. By the progressive tax they would separate in the levy the necessities from the superfluities, and, according to the amount of the superfluity, would take 1/4, 1/3, 1/2, and beyond 9,000 livres, the entire amount. So that the most opulent family would retain not more than 4,500 livres of income."

Babeuf is quoted in *Seligman* "Progressive Taxation," 2nd ed., page 137, as advocating the progressive tax for the following reason (free translation):

> "The progressive tax would furnish an efficacious means of splitting up property, of preventing the accumulation of fortunes, and banishing idleness and luxury."

*Seligman*, at page 140, also quotes M. Dufay (free translation):

> "Taxation should play not only an economic but a moralizing role. It should free labor, should take from capital its excessive power."

*Seligman*, at page 142, quotes from M. des Essarts (freely translated):

> "Progressive taxation is the result of the envy of those who have not against those who have."

And on the same page from R. Stourn (freely translated):

> "It is an instrument of general spoliation and confiscation, which seeks to bring about a social equality by suppressing inheritances and confiscating all fortunes above the necessities."

In addition, the act is discriminatory in that it provides for a different method of computing net income for the purpose of the normal tax, and in computing net income for the purpose of the additional tax. Thus in computing net income of persons whose incomes are less than $20,000 and therefore subject only to the normal tax, the person making the return is not required to make a return of the income derived from dividends on capital stocks, or from the net earnings of corporations, &c., taxable upon their net income as provided. The person whose income exceeds $20,000 must return all such dividends and receipts from such net earnings.

It avails nothing to say that there is a reason for such a classification. There is always a reason for every classification; and the Court's very duty in this regard is to consider the reason. In 1691 the English Parliament "taxed Protestants at a certain rate, Catholics as a class at double the rate of Protestants, and Jews at another and separate rate" (*Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S. 429, 596). The English Parliament doubtless had a reason for thus classifying taxpayers according to their religion, just as a Tennessee Legislature of late years had a reason for denying non-resident creditors distributive rights equal to those possessed by domestic creditors in the case of a failing Tennessee debtor. But the mere fact that a reason existed for making a discrimination between different members of the Commonwealth never satisfied this Court without inquiry into the reasonableness of the reason. The fact that the Tennessee Legislature desired to discourage foreign commission houses from dealing in Tennessee did not prevent this Court from declaring the resulting statute

unconstitutional (*Blake* v. *McClung*, 172 U. S. 239). The fact that the English Parliament of 1691 taxed Catholics at a higher rate than Protestants did not serve as a deterrent to the agitation, led by such men as Sir Samuel Romilly, which afterward led to the repeal of the discrimination against Catholics in the early part of the Nineteenth Century. The inquiry, therefore, is not whether there is a reason for such classification, but whether this reason is consonant with the principles which lie at the base of our institutions. If progressive taxation does not accord with the constitutional theories of taxation as expounded by this Court, then all the expositions of theorists avail nothing to the contrary.

## POINT III.

### In the light of its history it is clear that the Sixteenth Amendment does not sanction progressive taxation.

The question involved is the interpretation of the Sixteenth Amendment. It authorized an income tax. Did this authority include the power to establish a progressive system of taxation? The precise language of the statute does not justify such a conclusion, because the progressive feature is not inseparable from the ordinary acceptation of the income tax. It was not until the last year or so that England had a progressive income tax, and yet England continuously has had an income tax since the days of Sir Robert Peel. The last National Income Tax Law which this country had (Act of 1894) possessed no progressive features. There-

fore, to say that the authorization of an income tax included the authorization of the progressive feature, involves an interpretation of the Sixteenth Amendment; and that includes the inquiry whether the income tax, as expressing a common conception, necessarily connotes a progressive system of taxation.

It is a mere truism that a constitutional provision, like a statute, must be interpreted in the light of history. That was true of the original provisions of the Constitution; their interpretation rested, and will always rest, on the history of the original Colonies. "The history of the Colonies, and of the States into which they grew, is," to use the words of Mr. Justice STORY, "the highest and most authentic evidence to which we can resort to interpret" (the Constitution); and to disregard this history, as he has said, "would be to blind ourselves to the practical mischiefs which the Constitution was meant to suppress, and to forget all the great purposes to which it was to be applied" (*Briscoe* v. *Bank of Kentucky*, 11 Pet. 332).

The amendment adopted in 1913 involves, of course, a consideration of history more modern than that of the Colonies, but nevertheless history. At all times and in all places, therefore, to use the words of Mr. Justice BRADLEY, the Constitution "is to be interpreted in the light of history and of the circumstances of the period in which it was framed" (*Legal Tender Cases*, 20 Wall. 457).

In its study of history to which this task of interpretation leads, however, the Court must properly orient itself to historical phenomena. In asking itself whether the authorization of an income tax included the authorization of progressive taxation, it will be of no satisfaction to note the fact

that progressive taxation has appeared here and there in our history or the history of other nations. Such facts must be considered in their proper setting, and not *in vacuo*.

The fact that evil practices occurred at certain earlier points in our history is no argument for sustaining them to-day, because the development of Anglo-Saxon institutions is one long chronicle of evils overcome, rather than a record of heavenly perfection. The fact that the Court of King's Bench once was disgraced by Lord Jeffreys is surely no argument against the life tenure of judges, but rather the career of Lord Jeffreys is of historical value in showing the origin of the practice of vesting the judge with a life tenure rather than making him subject to the will of the sovereign then being, whether it be King or mob. To gain a proper historical perspective of our institutions, and to judge innovations in the light of our constitution, involves the examination of bad instances of the past, but not so as to serve as justification for modern aberations. Rather are they of value in teaching what our Constitution forbids.

If, then, there have been in the early history of England, or even in the history of our States, instances of progressive taxation, that circumstance does not answer the question whether the Sixteenth Amendment in the use of the term "income tax" meant to authorize such a tax. The question is not whether such a tax ever was imposed, but whether the common and ordinary use of the term "income tax" includes a progressive income tax.

It is a matter of common knowledge that the Sixteenth Amendment is the result of the agitation which followed this Court's decision in *Pollock v. Farmers Loan & Trust Co.* (157 U. S. 429, 158 U. S

601). In that case this Court was asked to determine the constitutionality of the national income tax law of 1894. In its first decision (157 U. S. 429) this Court decided that the statute was unconstitutional, insofar as it imposed a tax upon the income from real estate and the income from municipal bonds. In its second decision (158 U. S. 601) this Court was called upon, as the Chief Justice said, "to broaden the field of inquiry, and to determine to which of the two great classes a tax upon a person's entire income, whether derived from rents or products, or otherwise, of real estate, or from bonds, stocks or other forms of personal property, belongs." The result was the conclusion of this Court that "the enforced subtraction from the yield of all of one's real or personal property in the manner prescribed was" a direct tax within the meaning of the constitutional provision directing that direct taxes be apportioned. As the tax was not apportioned among the States this Court held that the statute imposing it was unconstitutional (158 U. S. 601).

The result of the decision in the *Pollock* case was that, in the absence of an amendment to the Constitution, which should authorize Congress to impose an income tax, without apportionment and without regard to census or enumeration in that connection, it would be practically impossible for the Federal Government to derive any revenue by means of an income tax.

The agitation which then commenced, and which found its way into the platforms of political parties at various times, was simply for that sort of an amendment to the Constitution which would allow an income tax of the kind which this Court had condemned under the Constitution as it then stood.

One of the strongest texts upon which the popular demand was based is the following oft-quoted extract from the dissenting opinion which Mr. Justice HARLAN rendered in the *Pollock* case:

"There is no tax which, in its essence, is more just and equitable than an income tax, if the statute imposing it allows only such exemptions as are demanded by public considerations and are consistent with the recognized principles of the equality of all persons before the law, and, while providing for its collection in ways that do not unnecessarily irritate and annoy the tax payer, reaches the earnings of the entire property of the country, except governmental property and agencies, and compels those, whether individuals or corporations, who receive such earnings, to contribute therefrom a reasonable amount for the support of the common government of all."

*Pollock* v. *Farmers Loan & Trust Co.* (158 U. S. 601, 676).

The income tax law of 1894, which, under the Constitution as it then stood, this Court has declared to be impossible of realization, contained no progressive features. There is nothing in the language of Mr. Justice HARLAN to justify a progressive income tax; on the other hand, the very idea of a progressive tax is opposed to every line of Justice Harlan's opinion. The agitation was to enact into constitutional form the ideas expressed by the minority members of this Court in the *Pollock* case; and there was nothing, in the minds of those furthering the agitation, as an object of accomplishment beyond the restoration of an income tax of the kind which had been enacted in 1894 and had been condemned in the *Pollock* case.

The language of the Sixteenth Amendment conforms entirely to this idea. It authorizes exactly the kind of income tax which this court had before it in the *Pollock* case, and no more, namely, a tax "on incomes from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." That is the kind of tax which this Court had declared could not be laid by Congress without amendment of the Constitution. This Court had held that an income tax is a property tax and therefore a direct tax. The Sixteenth Amendment says that Congress shall lay such a tax on incomes "from whatever source derived". This Court had determined that an income tax, being a property tax, must be imposed under the Constitution by way of apportionment among the several States, and therefore upon a basis of census or enumeration. The Sixteenth Amendment declares that the tax may be imposed "without apportionment among the several States, and without regard to any census or enumeration." The income tax which this Court condemned in the *Pollock* case contained no progressive feature, and the Sixteenth Amendment does not mention progression as a feature of the income tax which it authorizes Congress to impose.

The idea of an income tax, commonly entertained, does not connote progression. There may be an income tax without the progressive feature. Such was the income tax of 1894; and that was the last income tax with which the people of the present generation are personally familiar. The corporation tax of 1909 was commonly spoken of as income tax on corporations, and contained no progressive feature. The decision of this Court that

the statute of 1894, imposing an income tax, was unconstitutional led to the agitation which resulted in the Sixteenth Amendment permitting such a tax. It is incumbent upon anyone justifying the progressive feature of the present income tax in view of its extraordinary character and results, and its violation of the ideas of equality and uniformity, to show that progressive taxation was in such common use among us that it can fairly be assumed that the people had it in mind as an ordinary incident of any income tax when the Sixteenth Amendment came before the States for adoption. Is that the case? Was progressive taxation a feature of our institutions at the time the income tax amendment was adopted, or had it been in common use prior to that time?

Doubtless progressive taxation has appeared in the history of comparatively modern times. For example, the Republic of Florence at one time adopted a system of progressive taxation (Seligman, "Progressive Taxation", p. 21). In 1793 the young Republic of France adopted a property tax which was sharply progressive, reaching a confiscatory point as to property incomes exceeding a certain figure (Seligman, "Progressive Taxation" p. 34). England has had her example of such a tax; we have had it.

But these instances occupy no part in a consideration of the question to which this case addresses itself. The Florentine example above quoted is of no value because mediæval examples of economic theory have never been considered as enlightening. The "Wealth of Nations" was Adam Smith's protest against many of the theories which, up to his time, the Chancelleries of Europe had favored. Outside of the Italian example above

quoted, the appearance of a progressive tax in the history of the Eighteenth and early part of the Nineteenth Century was always accompanied by abnormal conditions.

Such was the case with France. Her progressive tax was imposed during the double strain of defending her borders against foreign enemies and of completing the domestic upheaval which ended in the dispossession of the large property owners and the re-distribution of the land among the peasantry. It was not long before the very tax which Prof. Seligman mentions was abolished (Seligman, "Progressive Taxation", p. 37) and the subsequent history of France, many as have been her crises, shows no repetition of this desperate recourse. "This was," says Seligman, "for a long time the end of progressive taxation in France, with the exception of a very minor impost on official salaries" (Seligman, p. 37). Indeed it is of interest to note that only two years ago a bill for an income tax was rejected by the French Parliament.

France's leading antagonist in the wars which followed the French Revolution adopted a graduated property tax which LORD AUKLAND denounced as confiscatory, but the close of the Napoleonic Wars was followed by its repeal; and the excerpts from authorities, which will hereafter follow, clearly show the subsequent state of English thought on this subject.

We have had our turn at such expedients. In 1798 the national direct property tax, adopted by Congress, was graduated in its features, and the so-called national income tax laws, adopted during the period between 1861-5, embraced progressive features. But in 1798 this country was feeling the

reflex of the European struggle. That year, which also saw the adoption of the Alien and Sedition Laws, has never been considered by historians as an average year in American history, to put it mildly. The period 1861-5 needs only to be mentioned to conjure up the struggle of the greatest Civil War of all times, and surely those years, which also witnessed trial by court martial and the suspension of the writ of *habeas corpus*, could not be referred to as specimens of ordinary times in the existence of a civilized commonwealth. The direct property tax law was of short duration. The income tax laws of the Civil War period were radical indeed; they taxed the salaries of judges, in plain contradiction of constitutional restraints. But the constitutionality of these statutes never was passed upon by this Court. (See Black on Income Tax, 2d ed., § 192; and appellant's brief in *Brushaber* v. *Union Pacific Ry. Co.*, No. 140, submitted herewith.)

The modern idea of progressive taxation is not institutional with us. Writing in 1889, Professor Gustave Cohn of the University of Göttingen says that "it is only recently and notably in German science that this principle has been generally accepted as the result of exhaustive discussion" ("Income and Property Taxes", 4 Pol. Sc. Quar. 37, 42).

Nor has the theory of the progression ever been so satisfactorily set forth as to meet common acceptance. Professor Cohn of Göttingen says that progression rests on the theory that "income from property is really better able to pay taxes than is income from earnings" (4 Pol. Sc. Quar. 37, 44). Professor Spahr, writing in 1886 ("The Taxation of Labor", 1 Pol. Sc. Quar. 400) says that this Ger-

man theory of progression means "that the ability to pay increases faster than the income, and that the percentage of compensation should be higher on the larger incomes. In accordance with this idea", he continues, "the income taxes of the different German states are progressive and not proportional. This system is favored by humane economists, yet the elaborateness and arbitrariness of these German systems of progressive taxation would condemn them in a country like our own. The progressive income tax, as Proudhon remarks, is a mere plaything of democracy. To tax an income of $600 4 per cent., and an income of $700 4½ per cent., is completely arbitrary." It is based upon no principle which is obvious enough to be made the basis of a practical system of reform" (1 Pol. Sc. Quar. 400, 404).

At no time during our recent history has there been any concurrence of opinion on the subject of the progressive tax. In the North American Review for March, 1880, Professor David A. Wells denounced progressive taxation as a socialistic experiment and confiscatory. And the foreign Professor Cohn, whom we have quoted, did not venture to recommend it for American use. His article was confined to an exposition of its operation in Switzerland and Germany. While Professor Seligman has supported it theoretically in his writings, yet we find this author in 1892 ("Theory of Progressive Taxation", 8 Pol. Sc. Quar. 220) assuming that the theory in practice cannot be universally accepted. He says:

> "If, therefore, we sum up the whole discussion we see that while progressive taxation is to a certain extent defensible as an ideal and as the expression of the theoretical demand for

> the shaping of taxes to the test of undivided facility, it is a matter of considerable difficulty to decide how far or in what manner the principle ought to be actually carried out in practice."
>
> (8 Pol. Sc. Quar. 251.)

The school of philosophy of which Mill and Bentham were expounders, continued to dominate the thought of this country as well as that of England until a very late day, and these ideas still prevail among so large a body of our citizens that the Sixteenth Amendment cannot be considered as having been the product of a public opinion which had changed. The records of both England and America abound with the expressions of the views which possibly a majority of the people of this country hold at the present day, and which certainly a majority held until very recently.

Professor Dicey, in the introduction to "Law and Opinion in England", calls to our attention the domination throughout the Nineteenth Century of English public thought by Mill and Bentham. "In harmony with these views," he says, "one principle was not only accepted but rigidly carried out by every Chancellor of the Exchequer according to his ability; it was that taxation should be imposed solely for the purpose of raising revenue, and should be imposed with absolute equality, or as near equality as was possible, upon rich and poor alike" (pp. 29-30). And again he says: "From, at any rate, 1845, till towards the end of the Nineteenth Century a taxing Act was generally held open to censure if it imposed a special burden upon one class of the community" (p. 52).

In Lord Morley's "Life of Gladstone" we find a graphic account of the views which Mr. Gladstone,

whose instincts always responded to the great middle class, maintained of Mr. Joseph Chamberlain's radicalism:

> "A few days later, more terrible things were said by Mr. Chamberlain at Birmingham. * * * He also advocated * * * a graduated income tax. * * * This deliverance was described by not unfriendly critics as 'a little too much the speech of the agitator of the future rather than of the minister of the present'.
>
> "Of this speech Gladstone wrote to Lord Granville:
>
> "'I think these declarations by Chamberlain can * * * hardly be construed otherwise than as having a remote and (in that sense) far sighted purpose which is ominous enough' ".
>
> Morley's "Life of Gladstone" (Vol. 3, p. 174).

To these let us add the following remarks of representative economists concerning progressive taxation:

*Lecky*, "Democracy and Liberty," Vol. 1, pp. 286, *et seq.:*

> "It is obvious that a graduated tax is a direct penalty imposed on saving and industry, a direct premium offered to idleness and extravagance. * * * It is at the same time perfectly arbitrary. When the principle of taxing all fortunes on the same rate of computation is abandoned, no definite rule or principle remains. At what point the higher scale is to begin, or to what degree it is to be raised, depends wholly on the policy of Governments and the balance of parties. The ascending scale may at first be very moderate, but it may at any time, when fresh taxes are required, be made more severe, till it reaches or approaches

the point of confiscation. No fixed line or amount of graduation can be maintained upon principle, or with any chance of finality. The whole matter will depend upon the interests and wishes of the electors; upon party politicians seeking for a cry and competing for the votes of very poor and very ignorant men. Under such a system all large properties may easily be made unsafe, and an insecurity may arise which will be fatal to all great financial undertakings. The most serious restraint on parliamentary extravagance will, at the same time, be taken away, and majorities will be invested with the easiest and most powerful instrument of oppression. Highly graduated taxation realizes most completely the supreme danger of democracy, creating a state of things in which one class imposes on another burdens which it is not asked to share, and impels the State into vast schemes of extravagance, under the belief that the whole cost will be thrown upon others. The belief is, no doubt, very fallacious, but it is very natural, and it lends itself most easily to the claptrap of dishonest politicians. Such men will have no difficulty in drawing impressive contrasts between the luxury of the rich and the necessities of the poor, and in persuading ignorant men that there can be no harm in throwing great burdens of exceptional taxation on a few men, who will still remain immeasurably richer than themselves. Yet no truth of political economy is more certain than that a heavy taxation of capital, which starves industry and employment, will fall most severely on the poor. Graduated taxation, if it is excessive or frequently raised, is inevitably largely drawn from capital. It discourages its accumulation. It produces an insecurity which is fatal to its stability, and it is certain to drive great masses of it to other lands."

*McCulloch on "Taxation"* (London, 1845), pp. 140, 141, *et seq.:*

"It is argued that, in order fairly to proportion the tax to the ability of the contributors, such a graduated scale of duty should be adoped as should press lightly on the smaller class of properties and incomes, and increase according as they become larger and more able to bear taxation. We take leave, however, to protest against this proposal, which is not more seductive than it is unjust and dangerous. * * * If it either pass entirely over some classes, or press on some less heavily than on others, it is unjustly imposed. Government, in such a case, has plainly stepped out of its proper province, and has assessed the tax, not for the legitimate purpose of appropriating a certain proportion of the revenues of its subjects to the public exigencies, but that it might at the same time regulate the incomes of the contributors; that is, that it might depress one class and elevate another. The toleration of such a principle would necessarily lead to every species of abuse. That equal taxes on property or income will be more severely felt by the poorer than by the richer classes is undeniable; but the same is true of every imposition which does not subvert the subsisting relations among the different orders of society. * * * Graduation is not an evil to be paltered with. Adopt it and you will effectually paralyze industry and check accumulation; at the same time that every man who has any property will hasten, by carrying it out of the country to protect it from confiscation. The savages described by Montesquieu, who to get at the fruit cut down the tree, are about as good financiers as the advocates of this sort of taxes. Wherever they are introduced security is at an end. Even if taxes on income were otherwise the most unexceptionable, the adoption of the prin-

ciple of graduation would make them about the very worst that could be devised."

*Bastable* "Public Finance" (1895), pp. 292, 293, 294, 555:

"It is entirely arbitrary. The possible scales are infinite in number, and no simple and intelligible reason can be assigned for the selection of one in preference to its competitors. * * * There is no self-acting principle by which to determine the scale of progression. * * * All depends on the will of the legislature, *i. e.*, in most modern societies, on the votes of persons who will not directly feel the charges placed on the higher incomes and will probably believe that they will be gainers by them. But behind any actual scale of progression lies the unavoidable danger of arbitrary extension in the future."

*Leroy-Beaulieu* "Traité d'Economie Politique" (1896), vol. IV., pp. 750, 764: (Freely translated)

"The progressive tax constitutes a veritable spoliation. It violates the rule established by all civilizations that taxation should be freely consented to by the persons taxed: for it is very clear, in this case, it is the mass of tax-payers who throw the great weight of the tax upon a certain few, and that these do not consent, even tacitly, to the surcharge placed upon them."

*Leroy-Beaulieu* "Science des Finances," vol. I, pp. 139, 140: (Freely translated)

"Thus, the theory of the progressive tax is not rational. It cannot stand an exact analysis of sociological facts. It is partial. It can have no scientific basis. The theory is, moreover, dangerous, because departing from the princi-

ple of equality of sacrifice it has an invincible tendency to try to correct social inequalities."

*Paul Beauregard "Elements d'Economie Politique,"* page 313 (freely translated):

"It is unjust, for it does not apportion the charge to the benefit obtained, and it casts upon some the charges which result in a profit to others; a result particularly serious in a country of universal suffrage, where the public charges are voted by representatives named by all the citizens. It is dangerous, for, taking away a large portion of great fortunes, it tends to discourage the spirit of enterprise and industry. Finally, it is arbitrary, for one cannot rationally determine the scale of progression which will equalize the charges imposed on each one."

*Mill* "Political Economy," Book 2, Section 3:

"To tax the larger incomes at a higher percentage than the smaller is to lay a tax on industry and earning; to impose a penalty on people for having worked harder and saved more than their neighbors. It is partial taxation, which is a mild form of robbery. A just and wise form of legislation would scrupulously abstain from opposing obstacles to the acquisition of even the largest fortune by honest exertions. Its impartiality between competitors would consist in endeavoring that they should all start fair, not that whether they were swift or slow they should all reach the goal at once."

*David A. Wells* "The Communism of a Discriminating Income Tax," *North American Review,* CXXX, 236, 239:

"Any exemption whatever, small or great, except to the absolutely indigent, is purely arbitrary; and the principle, once allowed, may

obviously be carried to any extent. Any exemption of any portion of the same class of property or incomes is an act of charity which every American ought to reject upon principle and with scorn, except under circumstances of great want and destitution. Equality and manhood therefore demand and require uniformity of burden in whatever is the subject of taxation."

*Seligman* "Progressive Taxation," 2nd ed., page 324:

"While progression of some sort is demanded from the standpoint of ideal justice, the practical difficulties in the way of its general application are well nigh insuperable. Progression is defensible only on the theory that the taxes are so arranged as to strike every individual on his real income. In default of a single tax on incomes, however, which is visionary, practicable tax systems can reach individual incomes only in an exceedingly rough and roundabout way. Under such practical conditions it is doubtful whether greater individual justice will be attained by a system of progression than by the simple rule of proportion; and it is highly questionable whether the ideal advantages of progression would not be outweighed for its practical shortcomings. For the United States at all events, the only important tax to which the progressive scale is at all applicable at present is the inheritance tax."

*Cooley on Taxation* (3rd ed., Vol. 1, p. 30):

"In some cases incomes in excess of the exemption have been taxed a larger percentage as they increase in amount. The reasons which favor this discrimination would also justify a heavier proportionate tax on the thrifty class in other cases; and a principle once estimated there is no reason but its own discretion why

> the legislature should stop short of imposing the whole burden of the Government on the few who exhibit the most energy, enterprise and thrift. Such a discrimination is a penalty on the possession of these qualities."

We need only add to that a speech made at Toledo in 1878 by Senator Sherman of Ohio, who, in his day, understood pretty well the views of the majority of the people of this country. "A free country," he said, "cannot take the property of the rich and divide it among the poor. It cannot, as is proposed, take the public treasure, collected by taxes, and distribute it in any other way than for the limited proper objects provided for by the Constitution" (Speeches of John Sherman, p. 623).

It is true that a change has come in English public thought on this subject, but the first outward manifestation of this thought did not appear until the Finance Act of 1910, of which Mr. Dicey, in the book quoted, says that its essential characteristic "lies not in its imposition of a heavy burden of taxation, but in its violation of the two principles which had been on the whole respected by Chancellors of the Exchequer during the greater part of the Nineteenth Century. It (by means of the super tax) imposes specially heavy taxes upon the rich and upon land owners. It is also an Act passed not for the mere purpose of raising needful revenue but with the aim of promoting social or political objects * * * for the attainment of social ends dear to the collectivists" ("Law and Public Opinion in England," p. liii).

But no one would venture the assertion that public opinion in this country has been educated up to collectivism in its broadest aspect, such as

has been imposed on the people of England. Let us examine the state of American thought at the time when the Sixteenth Amendment was offered to the States. We have already called attention to the fact that the Sixteenth Amendment was the result of agitation for the authorization of merely an income tax (such as this Court had declared unconstitutional in the *Pollock* case) with no super-added idea of progression. Progressive taxation was certainly not a feature of the popular demand. And in addition the trend of scientific thought in this country was against it.

In Professor Hadley's book on "Economics," published as late as 1901, he calls attention to the fact that "the more radical champions of progressive taxation insist on an increasing rate as well as the exemption of a fixed minimum" (Hadley's "Economics," p. 466). At the 1907 conference of the National Tax Association, Professor Raper, discussing "The Taxation of Incomes," said of progressive taxation:

> "Over this question there has been an almost endless amount of talk, but as I see it, we have come to no absolute agreement, if indeed to an approximate one * * * We have, to be sure, had statements—in fact, many dogmatic statements,—of how much the rate should progress with increasing income, but these statements are, as far as I am aware, entirely arbitrary and consequently foolish" (Conferences of National Tax Assn. for 1907, pp. 246, 248).

At the 1909 and 1910 sessions of the National Tax Association the Sixteenth Amendment (then newly proposed) was fully discussed, but no mention appears of progressive taxation as connected with its provisions or thereby authorized.

And finally, when the provisions of the present law were in course of legislative formulation, Senator Williams, of Mississippi, the chief exponent of the bill in the Senate, said of the schedule of progressive rates,

> *"This schedule constitutes to the extent to which it goes the introduction of an entirely new fiscal system. It is, so far as it goes, revolutionary of existing tax methods"* (Congr. Rec., Vol. 50, p. 4189).

In the present year we find, in the Annals of the Academy of Political Science, March, 1915 (vol. 78, p. 65 *et seq.*), a symposium on the progressive income tax. Among the contributors are a State Tax Commissioner of Wisconsin, who says that "prior to 1913 the income tax had never been generally adopted in this country" (Vol. cit., p. 77), and describes the Wisconsin tax as "primarily a tax upon the rich and well-to-do" (Vol. cit., p. 84); and the State Tax Commissioner of Virginia speaks of the Wisconsin Income Tax, which, as we shall see, expressly authorized progressive taxation, as "the most radical plan adopted by any State as a means of reaching intangible property" (Vol. cit., p. 101).

Now, when progressive taxation is considered a radical thing, it cannot, in the same breath, be spoken of as a commonly accepted thing. In this case the Court is called upon to judge a constitutional enactment in the light of current thought, rather than to read into it, in the language of Mr. Gladstone, "a remote and * * * far-sighted purpose which is ominous enough."

In the light of all this it seems clear that the Sixteenth Amendment was not intended to authorize

a progressive tax for which there had been no public demand, as there had been for simply an income tax.

Strong support for these views is furnished by the recent constitutional provision adopted by the State of Wisconsin. In Wisconsin the public mind apparently had been brought up to the point of desiring a progressive income tax, consequently the Wisconsin constitutional provision expressly provides for a progressive income tax; therein differing, and, we submit, fundamentally differing, from the national constitutional amendment. The Constitution of Wisconsin (as amended in November, 1908) contains the following provision:

> "Art. 8, § 1. * * * Taxes may also be imposed on incomes, privileges and occupations, *which taxes may be graduated,* and progressive and reasonable exemptions may be provided."

Pursuant to this, the Wisconsin income tax law, which contains progressive features, and, as we have seen, has been styled radical in the extreme, was adopted by Laws of 1911, C. 658.

The same thing may be said of the Constitution of South Carolina, which also expressly authorizes a progressive tax (Constitution, South Carolina, Art. 10, § 1; see *Alderman* v. *Wells,* 85 S. C. 507; 27 L. R. A., N. S. 864; *State* v. *Frear,* 148 Wisc. 456).

At the present moment, then, we find that a graduated income tax is of admitted force only in countries that impose no constitutional restraints upon the law-making power. In this country the only graduated income taxes of accepted place are those imposed by States whose constitutions expressly allow the graduation feature.

## POINT IV.

### Under the views which this Court has expressed in other cases involving similar principles, the discrimination effected by the present statute violates the express provisions of the Constitution.

This Court has repeatedly expressed its views on the theory of taxation, considered in the light of our institutions.

Mr. Justice FIELD has said that "the inherent and fundamental nature and character of a tax is that of contribution to the support of the Government, levied upon the principle of equal and uniform apportionment among the persons taxed, and any other exaction does not come within the legal definition of a tax." (*Pollock* v. *The Farmers' Loan and Trust Company*, 157 U. S. 429, 559.)

In *The Railroad Tax Cases* (13 Fed. 722), the same learned Judge said:

> "*It is not possible to conceive of equal protection under any system of laws where arbitrary and unequal taxation is permissible; where different persons may be taxed on their property of the same kind, similarly situated, at different rates, where, for instance, one may be taxed at 1 per cent. on the value of his property, another at 2 or 5 per cent.*, or where one may be thus taxed according to his color, because he is white or black, or brown, or yellow, or according to any other rule than that of a fixed rate proportionate to the value of his property."

In *County of Santa Clara* v. *Southern Pacific Ry. Co.* (18 Fed. Rep. 385, 400; aff'd 118 U. S. 394), Mr. Justice FIELD said, regarding the Fourteenth Amendment:

> "That amendment requires that exactions upon property for the public shall be levied according *to some common ratio to its value, so that each owner may contribute only his just proportion to the general fund.* When such exaction is made without reference to a common ratio, it is not a tax, whatever else it may be termed: *it is rather a forced contribution, amounting, in fact, to simple confiscation.*"

Mr. Justice BREWER, in *Gulf, Colorado & Santa Fe Ry.* v. *Ellis* (165 U. S. 150, 155), said:

> "It is equally true that such classification cannot be made arbitrarily. The State may not say that all white men shall be subjected to the payment of the attorney's fees of parties successfully suing them and all black men not. It may not say that all men beyond a certain age shall be alone thus subjected, *or all men possessed of a certain wealth. These are distinctions which do not furnish any proper basis for the attempted classification.* That must always rest upon some difference which bears a reasonable and just relation to the act in respect to which the classification is proposed, and can never be made arbitrarily and without any such basis."

In *State ex rel. Trustees, etc.* v. *Township Committee of Readington* (36 N. J. L. 66, 70) the Court says:

> "It is of the very essence of taxation that it should be equal and uniform, and that where the burden is common there should be a common contribution to discharge it. * * * When the amount levied upon individuals is

determined without regard to the amount or value exacted from any other individual or classes of individuals, the power exercised is not that of taxation but of eminent domain. *The People* v. *Mayor of Brooklyn,* 4 Comstock, 420. A tax upon the persons or property of A, B and C individually, whether designated by name or in any other way, which is in excess of an equal apportionment among the persons or property of the class of persons or kind of property subject to the taxation, is, to the extent of such excess, the taking of private property for a public use without compensation. The process is one of confiscation and not of taxation."

The Supreme Court of Kentucky, in *The City of Lexington* v. *McQuillan's Heirs* (9 Dana, 513, 516-7), said:

"An exact equalization of the burden of taxation is unattainable and *utopian.* But still there are well-defined limits, within which the practical equality of the constitution may be preserved, and which, therefore, should be deemed impassable barriers to legislative power. * * * The legislature, in the plenitude of its taxing power, can not have constitutional authority to exact from one citizen, or even one county, the entire revenue for the whole commonwealth.

"Such an exaction, by whatever name the legislature might choose to call it, would not be a tax, but would undoubtedly be the taking of private property for public use, and which could not be done constitutionally without the consent of the owner or owners, or without retribution of the value in money. * * *

"The object of this great guarantee was to secure every citizen against spoliation by a dominant faction, or by a rapacious public power, acting in obedience to the will of a constituent body for whose use his property may

be taken, and from whom no similar contribution is required."

The proposition now embraced in the progressive features of the present statute is thus presented by a representative American Judge:

> "A pretended classification that is based solely on a difference in quantity of precisely the same kind of property is necessarily unjust, arbitrary, and illegal. For example, a division of personal property into three classes with the view of imposing a different tax rate on each, class 1 consisting of personal property exceeding in value the sum of $100,000; class 2 consisting of personal property exceeding in value $20,000, and not exceeding $100,000; and class 3 consisting of personal property not exceeding in value $20,000, would be so manifestly arbitrary and illegal that no one would attempt to justify it." * * *
>
> Per *Sterrett, C. J.*, in *Cope's Appeal* (191 Pa. St. 22).

Although one of the great limitations upon the power of Congress to levy direct taxes has been abrogated by the Sixteenth Amendment, nevertheless its powers are not now unlimited.

The idea of uniformity enters into the very definition of a tax. *Cooley on Taxation,* 3rd Edition, Vol. 1, page 1, says:

> "Taxes are the enforced *proportional* contributions from persons and property levied by the State by virtue of its sovereignty for the support of government and for all public needs."

And at page 4:

> "They differ from the enforced contributions, loans and benevolencies of arbitrary and tyran-

nical periods in that they are levied by authority of law and *by some rule of proportion which is intended to insure uniformity of contribution and a just apportionment of the burdens of government.*"

Under our form of government this is an essential feature of taxation, and constitutes a limitation upon the power of Congress.

*Gray, Limitations on Taxing Power,* page 353:

"The view established by authority is that the words as used in the Constitution refer to *geographical uniformity.* It is not intended by this to say that Congress can lay indirect taxes violative of all the principles of equality and uniformity as between persons. Congress *is* limited in this regard, but its limitations are derived not from the words 'uniform throughout the United States,' but from the general nature of all legislative power to tax, from the inherent elements of uniformity and equality which partly make up the concepts of taxation and taxes. The restrictions upon Congress in this regard arise from the very nature of legislative power as a power held in trust for the whole people."

*Cooley, Constitutional Limitations,* pp. 607, 615:

"In the second place, it is of the very essence of taxation that it be levied with equality and uniformity, and to this end that there should be some system of apportionment. Where the burden is common, there should be a common contribution to discharge it. Taxation is the equivalent for the protection which the government affords to the persons and property of its citizens; and, as all are alike protected, so all alike should bear the burden. * * * Whatever may be the basis of taxation, the requirement that it shall be uniform is universal."

This principle has been many times recognized in this court.

In *Loan Assn.* v. *Topeka* (20 Wall. 655), Mr. Justice MILLER (p. 663) said:

> "The theory of our governments, state and national, is opposed to the deposit of unlimited power anywhere. The executive, the legislative and the judicial branches of these governments are all of limited and defined powers.
>
> "There are limitations on such power which grow out of the essential nature of all free governments, implied reservations of individual rights without which the social compact *could not exist,* and which are respected by all governments entitled to the name."

In *United States* v. *Singer* (15 Wall. 111), the Court (p. 121) said:

> "The tax imposed upon the distiller is in the nature of an excise, and the only limitation upon the power of Congress in the imposition of taxes of this character is that they shall be 'uniform through the United States.'"

In *Scholey* v. *Rew* (23 Wall. 331), Mr. Justice CLIFFORD, speaking of direct taxes (p. 348) said:

> "Mr. Hamilton said that the proportion of these taxes is not to be left to the discretion of the national legislature but it is to be determined by the numbers of each State as described in the 2nd Section of the First Article. An actual census or enumeration of the people must furnish the rule, a circumstance which shuts the door to *partiality or oppression.* 'In addition to the *precaution* just mentioned,' said he, 'there is a provision that all duties, imposts and excises shall be uniform throughout the United States.'"

In *M'Culloch* v. *Maryland* (4 Wheat. 316), Mr. Chief Justice MARSHALL (p. 435) said:

> "The people of all the states, and the states themselves, are represented in Congress, and, by their representatives, exercise this power. When they tax the chartered institutions of the states, they tax their constituents, *and these taxes must be uniform.*"

In *Loughborough* v. *Blake* (5 Wheat. 317), Mr. Chief Justice MARSHALL, speaking of the power of Congress to impose a direct tax within the District of Columbia (p. 325), said:

> "If it be said that the principle of uniformity, established in the Constitution, secures the District from oppression in the imposition of indirect taxes, it is not less true that the principle of apportionment, also established in the Constitution, secures the District from any oppressive exercise of the power to lay and collect direct taxes."

In *Ward* v. *Maryland* (12 Wall. 418), Mr. Justice CLIFFORD (p. 431) said:

> "Inequality of burden as well as the want of uniformity in commercial regulations was one of the grievances of the citizens under the Confederation, and the new Constitution was adopted among other things to remedy those defects in the prior system."

It is accordingly submitted that to tax "A" at a certain rate and at the same time to tax "B" at a rate six times as great violates the principle of uniformity inherent in our system of taxation, and constitutes on the part of Congress an exercise of power violative of the implied limitations above mentioned. A purely arbitrary classification has

been made based upon wealth alone. Citizens are taxed at radically different rates who differ from each other merely in the extent of their income. The burden of the expenses of government has been unequally distributed, many citizens of means and of a capital of approximately $100,000 being entirely exempt from contribution, whereas the great burden of government has fallen on citizens of considerable wealth.

It is true that some of the income tax laws passed during and shortly subsequent to the Civil War contained provisions for a surtax. As we have shown under a previous point, the question as to whether they were in this respect constitutional or whether they were lacking in uniformity because of this feature does not seem to have been raised.

It is also true that progressive taxation on inheritances has been sustained by this Court. Such taxation, however, does not constitute a precedent for the case at bar, for such taxation is not upon property but upon the right to succession, and the property taxed is not held by the owner as a matter of right but goes to the recipient as a matter of privilege from the State.

In *Magoun* v. *Illinois Trust & Savings Bank* (170 U. S. 283), wherein the inheritance tax of Illinois was before the Court, referring to precedents on the subject, this Court (p. 288) said:

> "It is not necessary to review these cases or state at length the reasoning by which they are supported. They are based on two principles: (1) An inheritance tax is not one on property, but one on the succession; (2) The right to take property by devise or descent is the creature of the law and not a natural right—a privilege and therefore the authority which confers it may impose conditions upon it. From these

> principles it is deduced that the state may tax the privilege, discriminate between relatives and between these and strangers, and grant exemptions; and are not precluded from this power by the provisions of the respective state constitutions requiring uniformity and equal taxation."

This Court further said (p. 298):

> "The reasoning of appellant is based on the view that the tax is one on property instead of one on the succession as held by the Supreme Court of the State. Being on the succession the Court further held, as we have seen, that the latter is to be regarded as new property and the $20,000 and other property not taxed are not therefore exemptions.
>
> "In this view the Illinois Court is in harmony with the majority of other courts of the country. We concur in the reasoning."

So also in *Knowlton* v. *Moore* (178 U. S. 41) the tax was on legacies. This Court (p. 47) stated that taxes of such character are universally deemed to relate not to property as such, but to its passage by will or by descent in cases of intestacy, as distinguished from taxes imposed on property, real or personal, as such, because of its ownership and possession. The tax is placed upon the gratuitous acquisition of property which passes by death.

The Court then followed the Magoun case, *supra,* and summarized the distinguishing features of this class of taxation (p. 56) by saying:

> "Nevertheless tax laws of this nature of all moneys rest in their essence upon the principle that death is the generating source from which the particular taxing power takes its being and that it is the power to transmit or the transmission from the dead to the living on which such taxes are more immediately rested."

In regard to the limitations implied on the power of Congress, even in this class of taxation, the Court (p. 77) said:

> "It may be doubted by some, aside from express constitutional restrictions, whether the taxation by Congress of the property of one person accompanied with an arbitrary provision that the rate of tax shall be fixed with reference to the sum of the property of another, thus bringing about the profound inequality which we have noticed, would not transcend the limitations arising from those fundamental conceptions of any government which underlie all constitutional systems. On this question, however, in any of its aspects, we do not even intimate an opinion, as no occasion for doing so exists, since, as we understand the law, we are clearly of opinion that it does not sustain the construction which was placed on it by the court below."

The Court further (p. 78), discussing the features which distinguished this class of taxation from taxation of property, said:

"That death duties, generally, have been from the beginning in all countries considered as different from taxes levied on property, real or personal, directly on account of the ownership and possession thereof as demonstrated by the review which we have previously made."

And in regard to the progressive feature in this class of tax, the Court (p. 109) said:

> "Lastly, it is urged that the progressive rate feature of the statute is so repugnant to fundamental principles of equality and justice that the law should be held to be void, even although it transgresses no express limitation in the Constitution. Without intimating any opinion as to the existence of a right in the courts to exercise the power which is thus invoked, it is ap-

parent that the argument as to the enormity of the tax is without merit. It was disposed of in *Magoun* v. *Illinois Trust & Savings Bank,* 170 U. S. 283, 293."

In short, *Knowlton* v. *Moore* holds that progressive taxation of successions does not violate uniformity.

The tax falls upon the transfer of property or the act of succession not upon the property itself. Progressive taxation involves the classification of the thing taxed by the value of the property involved. Progressive taxation of the act of succession involves classifying acts of succession according to the value of the property transferred and taxing them at different rates according to the differing values of such property, as may be prescribed. All acts of succession falling within any one class are uniformly taxed. As soon as the right of the legislature to thus classify acts of succession is established, the propriety of progressive taxation thereon must be conceded. Acts of succession are often classified in respect to the amounts involved for purposes other than taxation. Thus under the Decedent Estate Law of New York (Section 98) if the decedent leaves a widow and also a brother or sister the rule of distribution varies according to the value of the estate. It does not follow that the classification of property for taxation according to its value is reasonable.

The taxation of acts of succession, classified according to the value of the legacies or real estate transmitted is one form of taxation. The direct taxation of real and personal property is another form of taxation. One operates upon the act of bestowal of property upon one who has not earned it, who takes title subject to the burden of this form

of taxation. The other operates directly upon property after ownership has been acquired and directly withdraws from the owner part of his possessions.

It is true that a state would not have the right to classify successions by the value of the properties transferred were it not for its right to regulate those successions. This is the ground upon which the right of a state progressively to tax successions is placed. The right of the Congress progressively to tax successions is sustained first because it has always been conceded, second because the states have such right and the powers of Congress, generally speaking, extend to the subject of taxation by the states.

No state would have the right to tax property, real or personal, by a progressive tax. This would involve classification of property owners by their wealth. Such classification would be unreasonable and a violation of the fundamental proposition of substantial equality and uniformity that in the absence of constitutional provisions must underlie the exercise of the taxing power which must be by due principle of law.

> "That death duties, generally, have been from the beginning in all countries considered as different from taxes levied on property real or personal, directly on account of the ownership and possession thereof, is demonstrated by the review which we have previously made."
>
> *Knowlton* v. *Moore* (178 U. S. 78).
>
> See also *Scholey* v. *Rew* (23 Wall. 331).

In *Knowlton* v. *Moore* this Court thus construes the *Pollock* case:

> "The court holding that taxes on the income of real and personal property were the legal

> equivalent of a direct levy on the property from which the income was derived, and therefore required apportionment" (178 U. S. 81).

A succession tax is an excise or duty. The Constitution of the United States in prescribing that excises and duties shall be uniform taken in the light of the judicial interpretation of this language, that the uniformity required is geographical only, does not require that excises and duties should be equal and uniform as those words are used in state constitutions. In the absence of language to the contrary in the Constitution, direct taxation of property by Congress must be equal and uniform, because taxation that is not substantially equal and uniform is confiscation, even in the absence of constitutional limitations to equalization and uniformity.

*Knowlton* v. *Moore* refers to the general provision in state constitutions that taxes shall be equal and uniform and assumes that those levied by Congress by the rule of apportionment should be equal and uniform in their extensive character and operation upon individuals in the sense applied by state courts.

In *Pollock* v. *Farmers Loan & Trust Co.* (157 U. S. 429) it was contended that the statute was void for lack of uniformity. The Court summarizing the contention (p. 555) said:

> "Under the second head it is contended that the rule of uniformity is violated in that the law taxes the income of certain corporations, companies and associations, no matter how created or organized at a higher rate than the incomes of individuals or partnerships derived from precisely similar property or business,

> * * * these and other exemptions being alleged to be purely arbitrary and capricious, justified by no public purpose and of such magnitude as to invalidate the entire enactment."

The Court (p. 586) stated that inasmuch as the Justices who heard the argument were equally divided upon the question whether the tax was invalid for want of uniformity, no opinion was expressed on that subject. Mr. Justice FIELD, however, in his concurring opinion (p. 594) said:

> "The object of this provision (of uniformity) was to prevent unjust discriminations. It prevents property from being classified and taxed as classed, by different rules. All kinds of property must be taxed uniformly or be entirely exempt. The uniformity must be co-extensive with the territory to which the tax applies. Mr. Justice MILLER in his lectures on the Constitution (N. Y. 1891), pages 240, 241, said of taxes levied by Congress: 'The tax must be uniform on the *particular article;* and it is uniform within the meaning of the Constitutional requirement if it is made to bear the *same percentage* over all the United States. That is manifestly the meaning of this word as used in this clause. The framers of the Constitution could not have meant to say that the 'government in raising its revenues should not be allowed to discriminate between the articles which it should tax'. In discussing generally the requirement of uniformity found in state constitutions, he said: 'The difficulties in the way of this construction have, however, been very largely obviated by the meaning of the word "uniform" which has been adopted holding that uniformity must refer to articles of the same class. *That is, different articles may be taxed at different amounts provided the rate is*

*uniform on the same class everywhere with all people and at all times.'"*

And Mr. Justice FIELD (p. 599) further said:

"But there are other considerations against the law which are equally decisive. They relate to the uniformity and equality required in all taxation, national and state; to the invalidity of taxation by the United States of the income of the bonds and securities of the States and of their municipal bodies; and the invalidity of the taxation of the salaries of the Judges of the United States Courts.

"As stated by counsel: 'There is no such thing in the theory of our national government as unlimited power of taxation in Congress'. There are limitations as he justly observes of the powers arising out of the essential nature of all free governments; there are reservations of individual rights without which society could not exist and which are respected by every government. The right of taxation is subject to these limitations."

And further (p. 607):

"'If the court sanctions the power of discriminating taxation and nullifies the uniformity mandate of the Constitution' as said by one who has been all his life a student of our institutions 'it will mark the hour when the sure decadence of our present government will commence.' If the purely arbitrary limitation of $4,000 in the present law can be sustained, none having less than that amount of income being assessed or taxed for the support of the government, the limitation of future Congresses may be fixed at a much larger sum, at five or ten or twenty thousand dollars, parties possessing an income of that amount alone being bound to bear the burdens of government; or the limitations may be designated at such a sum as a board

> or 'walking delegate' may deem necessary. There is no safety in allowing the limitations to be adjusted except in strict compliance with the mandates of the Constitution which require its taxation, if imposed by direct taxes, to be apportioned among the states according to their representation, and if imposed by indirect taxes, to be uniform in operation, and so far as practicable, in proportion to their property, equal upon all citizens. Unless the rule of the Constitution governs, a majority may fix the limitation at such rate as will not include any of their own number."

As we have above seen, a progressive taxation on inheritances is no precedent for a progressive taxation on income. A man has as clear title to the income from his property as he has to any of his property and a man has as much right to his earnings as to anything he may possess. No element of succession or of gratuity is here present to justify the present tax. The dissenting opinion of Mr. Justice BREWER in *Magoun* v. *Illinois Trust & Savings Bank* (170 U. S. 283, 301) is therefore particularly applicable to the case at bar. He says:

> "I am unable to concur in the foregoing opinion so far as it sustains the constitutionality of that part of the law which grades the rate of the tax upon legacies to strangers by the amount of such legacies. If this were a question in political economy I should not dissent but it is one of constitutional limitations. Equality in right, in protection and in burden is the thought which runs through the life of this nation and its constitutional enactments from the Declaration of Independence to the present hour. Of course absolute equality is not attainable and the fact that a law, whether tax law or other, works inequality in its actual

operation does not prove its unconstitutionality (*Merchants Bank* v. *Pennsylvania,* 167 U. S. 461). But when a tax law directly, necessarily and intentionally creates an inequality of burden, it then becomes imperative to inquire whether this inequality thus intentionally created can find any constitutional justification. * * * But beyond this classification the statute provided that as to the third class, that is, strangers, the rate of taxation shall vary *with the amount of the estate;* in other words the actual tax to be paid does not increase simply as the legacy increases, which would be the rule of equality, but the rate of taxation is also increased as the amount of the legacy passes from one sum to another. Upon a legacy over $50,000, it is six per cent., while upon one under $10,000 it is only three per cent.

*"It seems to be conceded that if this were a tax upon property, such increase in the rate of taxation could not be sustained* but being a tax upon succession, it is held that a different rule prevails."

and further (p. 303):

"And now by this statute upon property passing in accordance with its statutes a tax is imposed; a tax unequal because based upon a classification purely arbitrary, to wit, that of wealth—a tax directly and intentionally made unequal. I think the Constitution of the United States forbids such inequality."

The Fifth Amendment to the Constitution forbids the taking of property without due process of law on the part of the Federal Government. We have seen what this Court, and, in common with it, the courts of this country, consider to be forbidden to a sovereign power, and that is the unjust discrimination of certain classes of persons for the

purposes of taxation or for the purpose of imposing upon them any other burdens of government. In its exercise of the taxing power, Congress itself is not immune from these restrictions. As Mr. Justice FIELD has said, "there are limitations upon the powers of all governments, without any express designation of them in their organic law; limitations which inhere in their very nature and structure" (*U. S.* v. *Erie Railway Co.*, 106 U. S. 327, 334).

Such limitations bind Congress in the exercise of its taxing power.

As is said in *Loan Assn.* v. *Topeka* (20 Wall. 655, 662):

> "It must be conceded that there are such rights (private rights) in every free government beyond the control of the state. A government which recognized no such rights, which held the lives, the liberty and the property of its citizens subject at all times to the absolute disposition and unlimited control of even the most democratic depositary of power, is, after all, but a despotism. * * * The theory of our governments, state and national, is opposed to the deposit of unlimited power anywhere. The executive, the legislative and the judicial branches of these governments are all of limited and defined powers. * * * There are limitations on such power which grow out of the essential nature of all free governments, implied reservations of individual rights without which the social compact could not exist, and which are respected by all governments entitled to the name. * * * Of all the powers conferred upon government that of taxation is most liable to abuse. Given a purpose or an object for which taxation may be lawfully used and the extent of its exercise is in its very nature unlimited. It is true that express limitation on the amount of tax to be

levied or the things to be taxed may be imposed by constitution or statute, but in most instances for which taxes are levied as the support of government, the prosecution of war, the national defense, any limitation is unsafe. The entire resources of the people should, in some instances, be at the disposal of the government.

"The power to tax is therefore the strongest, the most pervading of all the powers of government, reaching directly or indirectly to all classes of the people. It was said by Chief Justice MARSHALL, in the case of *McCulloch* v. *The State of Maryland* (4 Wheaton, 316), that the power to tax is the power to destroy. * * * This power can as readily be employed against one class of individuals and in favor of another so as to ruin the one class and give unlimited wealth to the other, if there is no implied limitation of the uses for which the power may be exercised."

There is, then, some constitutional limitation on the taxing power of the Federal Government. It exists, we submit, in the Fifth Amendment. The purpose of this amendment has been stated by this Court in years past. As is said by Mr. Justice SHIRAS, it does impose a curb on the Federal Government (*French* v. *Barber Asphalt Paving Co.*, 184 U. S. 324, 329). The very words used in the Amendment "by due process of law" have their equivalent, as expressed by Lord Coke, in the words "law of the land," and prohibit, among other things, taking private property for public use without just compensation (*Davidson* v. *New Orleans*, 96 U. S. 97, 101). This limitation is "as old as the principle of civilized government" and was "by the Fifth Amendment introduced into the Constitution of the United States as a limitation upon the powers of the national Government" (*Munn* v. *Illinois*, 94 U. S.

113, 123). The due process of law, as thus described, protects the citizen against "the arbitrary exercise of the powers of government unrestrained by the established principle of private right and distributive justice" (*Bank of Columbia* v. *Oakley*, 4 Wheat. 237, 244; *Caldwell* v. *Texas*, 137 U. S. 692, 697).

The Government may point to *Billings* v. *U. S.* (232 U. S. 261) as some authority against the views above expressed concerning the limitations imposed upon Congress. That was an action for a tax imposed by the Tariff Act of August 5, 1909, upon the use of every foreign built yacht owned by a citizen of the United States. The defense was that there were within the United States many pleasure yachts, not foreign built, of the same use as that of the yacht in question, and that the law imposing the tax was void because repugnant to the Fifth Amendment. The case was submitted to the Court upon the complaint and answer. In overruling this defense, this Court said that "the Constitution is not self-destructive. In other words, that the powers which it confers on the one hand, it does not immediately take away on the other; that is to say, that the authority to tax which is given in express terms is not limited or restricted by the subsequent provisions of the Constitution or the amendments thereto, especially by the due process clause of the Fifth Amendment. But these remarks were not necessary to the decision of the case, for this Court went on to say that the question in this case was simply one of uniformity. "The arguments of the defendant", the Court said, "come to this,—that to impose a burden in the shape of a tax upon the use of a foreign built yacht when a like tax is not imposed on the use of a domestic

yacht under similar circumstances, is so beyond the power of classification, so abhorrent to the sense of justice and so repugnant to the conceptions of free government as to be void even in the absence of express constitutional limitation". This Court, in saying that this contention was obviously unsound, because "the differences between things domestic and things foreign, and their use, are apparent on the face of things", goes on to say that "defendant's argument is an assertion that the tax which the statute imposes is void because of the want of intrinsic uniformity". That contention, this Court says, is answered by the previous decisions "that the requirements of uniformity which the Constitution imposes upon Congress in the levy of excise taxes is not an intrinsic uniformity, but a geographical one."

But we do not understand that this Court in the case cited denied that there is *some* limitation on Congress, and that a thing may be, as contended in that case, "so beyond the power of classification, so abhorrent to the sense of justice, and so repugnant to the conceptions of free government as to be void even in the absence of express constitutional limitation." Assuming that while in exercising its taxing power under the Constitution, Congress is subject to no limitation of the Constitution, it does not follow that if Congress undertakes to do something which does not amount to an exercise of the taxing power as conferred upon it by the Constitution, there is no limitation in the Constitution against such an act. That is our precise contention. We say here that Congress undertook to do something which was not an exercise of the taxing power as conferred upon it by the Sixteenth Amendment. To assert, as we do, that the restrictions of the

Fifth Amendment apply, is not to assert that the Constitution is self-destructive, but rather that it has coherency, and that Congress cannot, without this Court's condemnation, do something which that fundamental instrument not only does not authorize in its provisions relating to taxation, but forbids in the Fifth Amendment.

In *Southern Railway Company* v. *Greene* (216 U. S. 400) it was held that a statute which classified separately domestic and foreign corporations for the purpose of taxation and imposed a greater franchise tax upon foreign corporations than that imposed upon domestic corporations was an arbitrary selection and could not be justified by calling it classification in the absence of real distinction of a substantial basis. The Court said:

> "While reasonable classification is permitted without doing violence to the equal protection of the laws, such classification must be based upon some real and substantial distinction bearing a reasonable and just relation to the things in respect to which such classification is imposed, and classification cannot be arbitrarily made without any substantial basis. Arbitrary selection, it has been said, cannot be justified by calling it classification. (*Gulf, Colorado & Santa Fe Ry.* v. *Ellis*, 165 U. S. 150, 155, 165; *Cotting* v. *Kansas City Stockyards Co.*, 183 U. S. 79; *Connolly* v. *Union Sewer Pipe Co.*, 184 U. S. 540, 559)."

While the case above cited arose under the Fourteenth Amendment to the Constitution of the United States, and while it was held that the complaining corporation was a citizen within the jurisdiction of the State of Alabama and entitled to the equal protection of its laws under that amendment, the case is an additional authority to many in this Court

upon the proposition that while a legislative body possesses great powers in classifying subjects of taxation and imposing different rates of taxation upon different classes of subjects, the action of the legislature must be classification and not arbitrary selection. It is well said that the object of the Fourteenth Amendment was "to prevent any person or class of persons from being singled out as a special subject for discriminating and hostile legislation" (*Pembina Mining Co.* v. *Pennsylvania*, 125 U. S. 181, 188), but the principle of the Fourteenth Amendment that prevents this discriminating and hostile legislation is found in the implied limitations of the Constitution of the United States upon the taxing power of Congress. The power that is given to Congress is to levy and collect taxes, and amounts sought to be collected by legislation by the process of arbitrary selection and not by that of classification are not taxes, but arbitrary exactions and beyond the power of Congress to enforce. It has been frequently held that, notwithstanding the language of the Fourteenth Amendment in its guarantee of equal protection of the laws is not to be found in the Constitution of the United States, yet its principle is an implied limitation on the powers of Congress, and that the Constitution of the United States by implication requires Congress to see to it that in its legislation the citizens of the United States receive the equal protection of the laws of the United States.

The Income Tax Law in creating the surtax classifies individual citizens not with reference to their occupation but with reference to their respective degrees of wealth, and imposes different and increasing rates of taxation upon the citizens by reason of the possession of increasing amounts of income.

While it is the function of the legislature to classify, or to attempt to classify, for purposes of taxation, it is the function of the Court to inquire whether the result attained is classification or arbitrary selection. As "such classification must be based upon some real and substantial distinction bearing a reasonable and just relation to the things in respect to which such classification is imposed and classification cannot be arbitrarily made without any substantial basis", in the language of this Court (216 U. S. 417), it is the function of this Court to inquire whether any criticized classification is or is not based upon some real and substantial distinction, and whether such distinction does or does not bear a reasonable and just relation to the things in respect to which such classification is imposed. We are brought, then, face to face with the question whether or not variance in degrees of wealth is a real and substantial distinction between taxpayers that bears to them and to their incomes a reasonable and just relation in connection with the taxation of incomes.

The reason for this distinction, as given by the economic writers, is that the owner of a large income feels the burden of paying the tax less acutely than the owner of a small income, and, therefore, a larger rate should be imposed upon the one than that imposed upon the other. It is argued that a certain amount of income is essential to the support of life in reasonable comfort; that all income after that amount is substantially surplusage and available only for the purpose of procuring luxuries or of accumulation.

This is all true, in a general sense, but essentially speculative when applied to any individual. It is impossible to ascertain with any accuracy to

what extent any individual "feels" the burden of taxation. The measure of a man's faculty or facility in paying taxes is by no means his income. He may have many demands upon him that are not apparent that affect his faculty. He may be obliged to support a large family, both children and grandchildren. There may be invalids or insane members of the family who consume surpluses so that little remains for either luxuries or accumulation. There may be an accumulation of debts from former years that absorb the savings from even a very large income. There may be innumerable obligations, either moral or legal, to be met. Progressive taxation, based as it is upon the faculty to respond, cannot be administered with justice without a minute inquiry into the circumstances of each taxpayer. The only safe and sane rule is that of equality in the pecuniary burden upon incomes of the same size.

## POINT V.

### The discriminations which the statute effects, in regard to the progressive features of the tax, are illustrated by the exemptions which it allows.

We do not contend that it is not within the power of Congress to grant reasonable exemptions from the operation of tax laws. In the operation of a tax having a uniform rate there may be a point, with respect to classes of property, where the cost of collection of the tax may exceed its fruits; and in such a case it is only reasonable for the

Government to make an exemption. The exemptions granted by the present statute, however, on their face bear no relation to the standard just mentioned, nor, we submit, do they rest upon any standard which this Court, under the principles to which we have called attention, may allow.

The statute contains the following provision:

> "C. That there shall be deducted from the amount of the net income of each of said persons, ascertained as provided herein, the sum of $3,000, plus $1,000 additional if the person making the return be a married man with a wife, living with him, or plus the sum of $1,000 additional if the person making the return be a married woman with a husband living with her; but in no event shall this additional exemption of $1,000 be deducted by both a husband and a wife. *Provided,* That only one deduction of $4,000 shall be made from the aggregate income of both husband and wife when living together."

The effect of this provision is to exempt from the tax incomes of the classes above defined. From the present viewpoint, the statute divides the income owning public into two great classes, (*a*) those whose incomes exceed $3,000, and in the case of a married man living with his wife, $4,000, and (*b*) those whose incomes do not exceed $3,000 or $4,000 as the case may be. The one class is subjected to tax and supertax, as discussed under the preceding points; the other class pays no tax at all, and yet receives all the benefits of government.

What is the purpose of the present exemption? While this bill was in course of formulation in the House of Representatives, Mr. French of Idaho said:

> "After all, the reason for a minimum above which an income tax is required is that there

may be a figure established that may be regarded as the measure of living for the American family."

(Cong. Rec., Vol. 50, p. 2250.)

Taking that as the criterion, it is evident that there is a sharp difference of legislative opinion as to the proper measure of living for the American family.

In all of the States which tax incomes, on the other hand, the rate is much lower. In North Carolina (Laws 1907, C. 256) and Virginia (Acts 1903, C. 148, as amended by Acts 1908, C. 10), all incomes above $1,000 are taxed. In Massachusetts the incomes from annuities and ships engaged in foreign commerce are taxed without exemption, and the income from a profession, trade or employment is taxed in excess of $2,000 (Mass. Gen. Stats., C. 11, § 4). In South Carolina the income tax exemption is $2,500 (S. C. Code 1902, § 325); and in Oklahoma (Laws 1907, C. 730) the exemption is $3,500. In Wisconsin (Laws 1911, C. 658) exemptions are graded as follows:

| | |
|---|---|
| Bachelor or Spinster | $800 |
| Husband and wife | 1,200 |
| Each child or dependent | 200 |

The national statute fixes the minimum at $3,000 in the case of a bachelor or spinster without any children or other obligations, and at $4,000 in the case of marriage, whether or not there are minor children.

The standard fixed by the national statute is essentially arbitrary. This is illustrated by the changes which were made in the Bill in the course of its progress through Congress. The Bill as

originally introduced on April 7, 1913 (H. R. 10), provided for a deduction of $4,000, with no additional allowance in the case of a married man living with his wife. The Revised Bill, introduced April 1, 1913 (H. R. 3321), contained the same provision; and the Bill remained unchanged in this respect, as finally passed by the House (H. R. 3321). In the Senate the Bill was so amended that, as it stood when reported with amendments agreed to in Committee of the Whole, it provided for an exemption of $3,000 plus $1,000 additional if the tax payer be a married man living with a wife or a married woman living with her husband, and with an additional exemption, not exceeding $1,000, for minor children living with and dependent upon a taxable parent (H. R. 3321; Senate Calendar No. 62).

Thus, according to the House's view, the standard of living for a bachelor or spinster was $4,000, and there was no allowance for marriage. According to the Senate view, the standard of living for a bachelor or spinster was $3,000, for a married couple $4,000, and for a married couple with at least two children, $5,000. The final agreement between the Senate and the House, as expressed in the present Act, reduces the standard to $3,000 for a bachelor or spinster, plus $1,000 in the case of a married man living with his wife, and does nothing for minor children. Is not this evidence at least of the fact that the exemption, as finally fixed, was based upon no scientific method of reasoning, no patient examination of statistics as to the manner of living of the average American family or single persons, and was, in short, but the result of a compromise between two sets of figures, each in itself arbitrary?

In his discussion of the Bill while it was in the House, Mr. French of Idaho, after using the language already quoted, said: "It may be that the figures which have been placed in the Bill—$4,000—are too high. That is not the question here. The question is one of principle" (Congr. Rec. Vol. 50, p. 2251).

What is the principle to which this refers? It is stated in the same speech as this: "If our system of taxation is to be one that apportions taxes, not according to ability to pay, not according to amount of property owned by individuals, but so that each member of society shall pay an identical amount with his fellows, we had better abandon the income tax idea altogether. But such is not the case. The principle that is fast becoming recognized as cardinal or basic, and in which I firmly believe, is that the members of society shall pay taxes in proportion to their ability to pay" (Congr. Rec. Vol. 50, p. 2251).

In short, the unmarried man or woman with $3,000 income is unable to pay anything for the support of government; to that conclusion the statute forces us. But on what foundation does that conclusion rest? In Wisconsin the unmarried man or woman is able to contribute unless his income is less than $800, and the non-taxable income of man and wife is taxable above $1,200, with $200 for each child or dependent. In other states there is a flat exemption varying from $1,000 in Virginia and North Carolina to $3,500 in Oklahoma. This comparison alone must force us to abandon the theory that Congress, in fixing the present exemptions, intended to be guided by the necessities of the average citizen. Instead of that, Congress intended to raise revenue only from

certain classes, arranged according to their wealth alone.

The Senate debates demonstrate this.

Senator Shively said:

> "There is a difficulty always confronting a body which has to pass upon the question of where an income tax should begin. In England it begins with an income of £160 (about $800). Here we have fixed it at $3,000, or at nearly four times as high an amount. It is difficult to grade an income tax on the theory on which the Senator from Idaho proceeds. Of course it requires about so much to sustain a family. While there are large differences as to the amount of income required in this station of life, that station of life, the question confronting us was a fiscal one, the question of raising sufficient income, which, added to other income, will pay the expenses of Government" (Congr. Rec., Vol. 50, p. 4188).

Senator Williams brought out the same idea:

> "What we are doing with this income tax is a totally different thing from what we hope to do some day. We do not want to collect any more revenue than we need. The Senator from Idaho says it is largely speculation instead of calculation, but we have calculated as well as we could how much income tax we would need for a reduction of the duties upon consumption. * * * Having concluded that we had enough, we are not taxing the people's incomes even for fun, nor are we taking them for the purpose of building up a system. The time may come, and I hope will some day, when all taxes for the Government will be raised by taxing the citizens in proportion to their ability to pay * * * But the Senator knows as well as I do that we cannot go at that sort of thing too quickly. * * * In revising the tariff we have tried to have that

> in view. * * * Having accomplished that, we made up the difference that we need in revenue from the income tax. We think this will make it. We saw no use in either raising the rate or changing the point of demarcation so as to increase the amount of revenue, which is what would be the effect. Now, the Senator says, and says very properly, that this income tax might be complicated so as to make it still fairer than it is in a way. For example, there might be a difference in exemptions, a difference in rates dependent on the source of the income * * * but we thought it well now to proceed slowly and cautiously and upon as simple grounds as we could inaugurate the system" (Congr. Rec., Vol. 50, p. 4189).

In other words, the exemption was not fixed upon a standard of living for the American citizen or family, or the basis which has been suggested by many economists, viz., the cost of collection to the Government. It was simply fixed, as Senator Williams says, from the standpoint of production of revenue and classification of wealth, Congress leaving it to future legislators to go at the matter in a more scientific way. It is impossible to deduce from this statute any other conclusion than that which Senator Williams and Senator Shively so frankly expressed.

Therefore we are led to the same proposition which confronted us in the case of the progressive features of this statute. A, whose income is $3,000 per annum, goes free of tax; likewise he goes free if he happens to be a married man living with his wife, as to $4,000 of his income. B, who has an income of $10,000, does not go free of tax, and of the tax derived from him A enjoys the benefit. Why this distinction between A and B? On what ground does it rest? The statute discloses no just ground.

Therefore, the points we have already submitted with regard to unjust discrimination we again insist upon in the present connection. No statute which arbitrarily distinguishes between citizens of this country, taxing one and exempting the other, can be sustained, unless there is some proper basis which is in accord with this Court's views as previously expressed. There is none in the present connection.

Persuasive authority on this proposition is afforded by the decision of the Hawaiian Supreme Court. In 1896 the Legislature of Hawaii adopted an income tax, from which were exempt, however, all incomes under $2,000. It was held that this violated the provisions of the Constitution, the Court saying:

> "It is well settled that the legislature has the power to classify objects of taxation, but it is equally well settled that selections cannot be made out of a class for taxation and others of the same class be exempted. The effect of this section of the Act would be to place the burden of this tax upon those whose annual incomes are over $4,000, and who constitute a minority of the community. It is argued that the exemption of incomes of $2,000 is reasonable and in furtherance of a public purpose, because the sum of $2,000 is the average annual cost of living of a family. This is a mere supposition and not to be taken for granted as true in our community. But if it be once conceded that exemptions so large as this can be made as a public benefit then exemptions of a much larger amount can be made which might place the whole burden upon the rich and if pushed to an extreme be a confiscation and not the proportional taxation authorized by the Constitution."
>
> *Campbell* v. *Shaw* (11 Hawaii, 112, 121).

## Conclusion.

The foregoing argument does not involve any attack upon the Government or its powers. It involves a loyal recognition of the basic fact of our organization, that the people of the United States are the repository and fountain of all governmental powers, and that their will as expressed in the Constitution delivers the last word upon any subject dealt with. It involves also a recognition of the fact that the great purpose of the existence of the Constitution, is not only that it may by its terms *positively* express the will of the people, but also that by its omissions and limitations it may also *negatively* express that will. The saving clause that all powers not granted to the United States are reserved to the States or the people, contains this thought. It is a check upon action by Congress that would go beyond the mandate of the people, as expressed in the Constitution, in resistance of pressure that apparently comes from a considerable body of voters. The rights of minorities are protected and safeguarded by the Constitution against the onslaught of majorities, and can only be modified by an amendment of the Constitution in the manner therein prescribed for enlarging the powers of the government, by the votes of the legislatures of two-thirds of the states. This machinery ensures full deliberation, with the opportunity of discussion, and of that hearing and day in court, that is universally regarded as essential to judgment upon either men or measures.

The people have decreed an income tax, but not a progressive income tax; and they have spoken in

no uncertain way. When this Court is asked to interpret the popular will, expressed in the Constitution, in favor of this radical, unequal and oppressive method of taxation, one absolutely undemocratic and fitted only for an aristocratic or oligarchic form of government, it is confidently hoped that the proposition will not receive judicial sanction.

## POINT VI.

**Inasmuch as a large amount of the taxed income actually accrued to and was received by the plaintiff prior to October 3, 1913, the date of the adoption of the statute, and there was no competent evidence before the Commissioner that any income whatever had been received by the plaintiff subsequent to that date, the statute is not justified by the Sixteenth Amendment, and the tax was illegally collected.**

This point is discussed in the appellant's briefs submitted in the case of *Brushaber* v. *Union Pacific Railway Co.*, to which the Court is respectfully referred.

## POINT VII.

**The judgment should be reversed, and the demurrer overruled, with leave to the defendant to answer.**

Dated September 21, 1915.

JULIEN T. DAVIES,
BRAINARD TOLLES,
GARRARD GLENN,
Mat. C. Sherman

Counsel.

# TYEE REALTY COMPANY *v.* ANDERSON, COLLECTOR OF INTERNAL REVENUE.

## THORNE *v.* SAME.

ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK.

Nos. 393, 394. Argued October 14, 15, 1915.—Decided February 21, 1916.

*Brushaber* v. *Un. Pac. R. R.*, *ante*, p. 1, followed to effect that the Income Tax provisions of the Tariff Act of 1913 are not unconstitutional either because not sanctioned by the Sixteenth Amendment and otherwise beyond the general taxing power of Congress, or because of its retroactive operation for a designated period, or because of discriminations, inequalities or progressive increases on incomes of individuals or the method provided for computing income of corporations.

THE facts, which involve the constitutionality and construction of the Income Tax Law of 1913, are stated in the opinion.

*Mr. Julien T. Davies*, with whom *Mr. Brainard Tolles*, *Mr. Garrard Glenn* and *Mr. Martin A. Schenck* were on the brief, for plaintiffs in error:

The effect of the Sixteenth Amendment was merely to waive the requirement of apportionment among the States in its application to a general and uniform tax upon incomes from whatever source derived. The Income Tax Law of 1913, except in so far as the tax thereby imposed is in reality such a general and uniform tax on incomes, derives no support from the Sixteenth Amendment.

In its progressive feature, the statute classifies persons according to their wealth in a manner which is both arbitrary and unreasonable.

In the light of its history, it is clear that the Sixteenth Amendment does not sanction progressive taxation.

Under the views which this court has expressed in other

cases involving similar principles, the discrimination effected by the present statute violates the express provisions of the Constitution.

So much of § 2 of the Act of October 3, 1913, as limits the interest which may be deducted in ascertaining the taxable income of a corporation to the interest accrued and paid within the year on an amount of indebtedness not exceeding one-half of the sum of its interest-bearing indebtedness and its paid-up capital stock, is invalid. The discrimination is unwarranted by the Sixteenth Amendment. The tax does not rest upon income in the true sense of the word. The classification is arbitrary and unreasonable.

The discriminations which the statute effects, in regard to the progressive features of the tax, are illustrated by the exemptions which it allows.

Inasmuch as a large amount of the taxed income actually accrued to and was received by the plaintiff prior to October 3, 1913, the date of the adoption of the statute, and there was no competent evidence before the Commissioner that any income whatever had been received by the plaintiff subsequent to that date, the statute is not justified by the Sixteenth Amendment, and the tax was illegally collected.

Numerous authorities sustain the contentions of plaintiff in error.

*The Solicitor General* and *Mr. Assistant Attorney General Wallace* for defendant in error.[1]

Mr. Chief Justice White delivered the opinion of the court.

Both the plaintiffs in error, the one in 393 a corporation and the other in 394 an individual, paid under protest

[1] For abstract of argument in this and other cases argued simultaneously herewith, see p. 5, *ante*.

to the Collector of Internal Revenue, taxes assessed under the Income Tax section of the Tariff Act of October 3, 1913 (§ II, ch. 16, 38 Stat. 166). After an adverse ruling by the Commissioner of Internal Revenue on appeals which were prosecuted conformably to the statute (Rev. Stat., §§ 3220, 3226) by both the parties for a refunding to them of the taxes paid, these suits were commenced to recover the amounts paid on the ground of the repugnancy to the Constitution of the section of the statute under which the taxes had been collected, and the cases are here on direct writs of error to the judgments of the court below sustaining demurrers to both complaints on the ground that they stated no cause of action.

Every contention relied upon for reversal in the two cases is embraced within the following propositions: (a) that the tax imposed by the statute was not sanctioned by the Sixteenth Amendment because the statute exceeded the exceptional and limited power of direct income taxation for the first time conferred upon Congress by that Amendment and, being outside of the Amendment and governed solely therefore by the general taxing authority conferred upon Congress by the Constitution, the tax was void as an attempt to levy a direct tax without apportionment under the rule established by *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429; 158 U. S. 601. (b) That the statute is moreover repugnant to the Constitution because of the provision therein contained for its retroactive operation for a designated time and because of the illegal discriminations and inequalities which it creates, including the provision for a progressive tax on the income of individuals and the method provided in the statute for computing the taxable income of corporations.

But we need not now enter into an original consideration of the merits of these contentions because each and all of them were considered and adversely disposed of in *Brushaber* v. *Union Pacific R. R.*, *ante*, p. 1. That case,

therefore, is here absolutely controlling and decisive. It follows that for the reasons stated in the opinion in the *Brushaber Case* the judgments in these cases must be and they are

*Affirmed.*

MR. JUSTICE MCREYNOLDS took no part in the consideration and decision of these cases.